UNEMPLOYMENT INSURANCE ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

JULY 11, 1996

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UNEMPLOYMENT INSURANCE ISSUES

THURSDAY, JULY 11, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:07 a.m., in room B–318, Rayburn House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
June 28, 1996
No. HR-13

CONTACT: (202) 225-1025

Shaw Announces Hearing On Unemployment Insurance Issues

Congressman E. Clay Shaw, Jr. (R-FL), Chairman of the Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on selected unemployment insurance issues. **The hearing will take place on Thursday, July 11, 1996, in room B-318 of the Rayburn House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be heard from invited witnesses only. Witnesses will include State governors, State unemployment insurance directors, employers, and other experts on unemployment insurance issues. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Federal-State unemployment compensation system is designed to provide temporary benefits to individuals with a recent work history who become involuntarily unemployed. In determining whether a worker's employment record is sufficient to qualify for benefits, 47 States consider only wages earned over 4 of the last 5 completed calendar quarters (called the worker's "base period"). A few States also consider the worker's eligibility under an "alternative base period," increasing the likelihood that these workers will qualify for benefits. A recent Illinois Federal court decision (*Pennington v. Doherty*) has now called into question what formerly was assumed by States -- that the Social Security Act provides States with the authority to select their own base period, which need not include the use of an alternative base period. If every State were required to use an alternative base period, as the *Pennington* decision foreshadows, the consequences could be significant in terms of higher benefit payments and higher payroll taxes.

The Subcommittee is also interested in various proposals, referred to generally under the term "devolution," that have been developed by several States to increase State flexibility in the operation of their unemployment compensation system. Proponents argue that allowing States greater authority would lead to lower payroll taxes, reduced business paperwork, and improved efficiency in labor markets across the country. While no bill has been introduced in the current Congress, the Subcommittee is interested in considering suggestions for change that promise increased employment and business growth while preserving the principles of the current unemployment insurance system.

In announcing the hearing, Chairman Shaw stated: "Keeping the unemployment insurance system operating smoothly and efficiently is important to employees, employers, and the U.S. economy. This hearing is part of our ongoing efforts to ensure that the current system is working well and to explore ways of making it even better in the future."

(MORE)

FOCUS OF THE HEARING:

The hearing will focus on two main issues. First, witnesses will discuss the implications of the *Pennington* case, a Federal court decision that has drawn into question whether States have full authority to set base periods used in determining eligibility for unemployment insurance benefits. Second, the Subcommittee will consider testimony on devolution proposals that would allow greater State control in setting and collecting unemployment taxes and in administering State unemployment insurance programs. In addition, other witnesses will discuss the way the unemployment insurance system affects actors and poll workers, among other issues.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Thursday, July 25, 1996, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Human Resources office, room B-317 Rayburn House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS_MEANS/' or over the Internet at 'GOPHER.HOUSE.GOV' under 'HOUSE COMMITTEE INFORMATION'.

*****

Chairman SHAW. We will go ahead and start the hearing.

Last night, there were a number of votes on the floor that I understand have been rolled over to today. When they call for votes, we will have to go down to the floor. We will have to recess for the appropriate time, so that people don't have to wait for us to come back.

Keeping the unemployment insurance system operating smoothly and efficiently is important to more than 100 million employees, the millions of employers, and to the strength and vitality of the U.S. economy.

In keeping with this Subcommittee's oversight of unemployment insurance, this hearing has two goals; first, to examine steps that Congress must take in the coming weeks to keep the system running efficiently, and second, to consider long-term changes to improve the system in years to come.

Our first panel involves an issue that demands immediate attention. Since its inception in the thirties, there has been universal agreement that the States have the right to set base periods used to determine eligibility for unemployment benefits until now. A Federal court decision in Illinois, the *Pennington* case, means that 47 States now face the possibility of being forced to adopt a new more liberal standard for determining the eligibility of unemployment benefits.

Unless Congress acts quickly, almost every State will be forced to pay higher unemployment insurance benefits resulting in more redtape, higher taxes on employers, and less job creation. Overall, added cost could reach as high as $1 billion each year.

After this hearing, I plan to move legislation to the House floor to fix this problem. Given the huge number of States affected, and the administration's support for the Illinois position in a 1994 amicus brief, I hope this can be a bipartisan effort.

Our second major panel will examine proposals designed to increase State flexibility in operating their unemployment systems. Bipartisan proponents argue that reforms can lead to lower payroll taxes, less paperwork, and improved efficiency in labor markets across the country.

Several States already have detailed proposals, and I understand that the National Governors' Association meeting this weekend will include discussion of such reforms.

So, even though we probably will not act on legislation until next year, this Subcommittee needs to start examining the comprehensive calls for change coming from Republican and Democrat Governors all across this Nation.

On our final panel, one of our Subcommittee colleagues, Phil English, will discuss this bill to expand benefits for the long-term unemployed and to make it more likely that States will have sufficient reserves to weather future recessions.

Congressman Upton and Congressman Farr will discuss their bill on pollworkers, and Charlton Heston, speaking on behalf of the Screen Actors Guild, will describe legislation of interest to entertainers.

Let me warn my colleagues that any bad puns connecting unemployment insurance with Mr. Heston's movie roles may result in

Members being forced to wander about the desert for the upcoming 40 years.

The opening statement of Mr. Ford, without objection, will be made a part of the record at this time.

[The opening statement of Mr. Ford follows:]

OPENING STATEMENT OF HON. HAROLD E. FORD

Mr. Chairman, I want to thank you for convening this unemployment compensation hearing today. I hope it is the beginning of a bipartisan review of how well our Nation's unemployment program is working and what steps, if any, we need to take to improve it.

I come to this session with an open mind. I have no preconceived notion of the reforms that are needed in the system and am anxious to hear what all the players—DOL, the States, employers, and workers—have to say.

I do want to urge caution, however, with regard to the so-called *Pennington* case. As I understand it, both the State of Illinois and the Department of Labor disagreed with the conclusion reached by the appeals court in *Pennington.* The State has the right to appeal that decision and has done so. I am inclined to let the legal process play itself out before we consider a legislative remedy to just this narrow problem.

After all, the Advisory Council on Unemployment Compensation—which we established to suggest reforms for this program—has made a mumber of recommendations, including several that pertain to the calculation of the base period.

I suggest that we take the time now to carefully review all legislative proposals that have been made and develop a consensus package of reforms, rather than cherry pick just one issue.

I look forward to the testimony.

Chairman SHAW. I would like to yield at this point to Congressman Phil Crane who has joined us for the purpose of making an introduction.

Mr. CRANE. Thank you very much, Mr. Chairman.

As you know, Illinois has been engaged in litigation regarding the base period used to determine the eligibility for unemployment compensation, and while the outcome of this suit will unquestionably have a significant impact on Illinois, it may also lead to changes across the country. The final ruling could lead to greatly increased costs, both for individual States and the Federal Government, but perhaps even more troubling is the circumvention and misinterpretation of congressional intent through judicial action.

Later today, I will introduce legislation which would clarify current law to protect the rights of States to determine their own base periods. I don't believe that this is a radical change, but merely reinforcement of what had been the common understanding of the law.

To help explain the need for this action, it is my pleasure to have the opportunity to introduce to you the comptroller of my home State of Illinois, Loleta Didrickson. Loleta is uncommonly qualified to speak on this issue having served not only as the director of the Illinois Department of Employment Security, but also as a member of the Illinois House of Representatives for four terms.

She was elected to her current position in 1994, becoming the highest ranking Republican woman ever elected in Illinois.

I know you will find her expertise and testimony useful in understanding this complex issue, and I hope that the Members of this Subcommittee will support my legislation.

Thank you, Mr. Chairman.

Chairman SHAW. Thank you, Mr. Crane.

I would like at this time to invite the first panel to the witness table. It will be Raymond Uhalde, the Deputy Assistant Secretary of the Employment and Training Administration of the U.S. Department of Labor. He is accompanied by Mary Ann Wyrsch, Director of the Unemployment Service.

In addition to the comptroller from the State of Illinois, we have Andrew Richardson who is commissioner of the West Virginia Bureau of Employment Programs, on behalf of the Interstate Conference of Employment Security Agencies, and Albert Miller who is president of Phoenix Closures, Inc., Naperville, Illinois.

Welcome. Mr. Uhalde, if you would like to lead off.

All of the witnesses' full statements will be made a part of the record.

You may proceed as you wish. We encourage you to summarize if you feel comfortable in doing so.

STATEMENT OF RAYMOND J. UHALDE, DEPUTY ASSISTANT SECRETARY OF LABOR, EMPLOYMENT AND TRAINING ADMINISTRATION, U.S. DEPARTMENT OF LABOR; ACCOMPANIED BY MARY ANN WYRSCH, DIRECTOR, UNEMPLOYMENT INSURANCE SERVICE

Mr. UHALDE. Thank you, Mr. Chairman and Members of the Subcommittee. I want to introduce Mary Ann Wyrsch who is the Director of the Unemployment Insurance Service in the Employment and Training Administration, U.S. Department of Labor.

Before discussing the *Pennington* decision, I believe we ought to give a little bit of background on the issue of the base period and the establishment of base periods under the UI, Unemployment Insurance, Program.

State UI laws identify a base period for measuring the wages earned by an individual from employment that is covered under the unemployment insurance system. Earnings during the base period are then used as the basis for determining whether the individual qualifies for unemployment benefits, and are also used to determine the weekly benefit amount and the duration of benefits.

The primary base period that has been defined for most States has been a base period that is the first four of the last five completed calendar quarters, immediately preceding the first day of an individual's benefit year.

Two States use as the base period the 52 weeks preceding the benefit year. Two States use the last four quarters, and one State uses four quarters ending 4 to 7 calendar months before the benefit year, and one State uses a uniform calendar year.

In addition to the primary base period, seven States presently provide for an alternative base period if the claimant does not meet the qualifying requirements using the primary base period.

The interval between the end of the base period and the beginning of the benefit year or the lag period or lag quarter is intended to allow time for the recording of the base period wages necessary to establish a benefit year prior to beginning of such year.

In States that use the first four quarters, the lag is 3 to 6 months. In States that use the last four quarters, the lag is less than 3 months.

While initially a long period of time was necessary to collect and post the wage information, technology has reduced this amount of time needed. All wages and covered employment earned during the base period, regardless of the number of different employers, are used in the determination of the qualification of benefits.

It is important to recognize that there are several advantages to the claimant in using the most recent wages possible. First, the most recent wages tend to be higher, and therefore, the benefit entitlement, both the amount of benefits and the duration of benefits, could be higher for a claimant.

Second, some claimants may have recent employment, but may not have wages reaching back five quarters and, therefore, would not have sufficient wages to qualify.

While there is nothing to prevent the claimant from waiting until the subsequent quarter to file a claim, during the interim the claimant may not have income support. The delay can be up to 6 months and may create financial hardships, particularly for low-wage and part-time workers.

Now, in the *Pennington* case, a claimant who was denied unemployment benefits because she did not have sufficient wages during the base period filed suit in Federal court in July 1985 claiming that Illinois base period was inconsistent with Federal law.

The claimant argued that the base period violated section 303(a)(1) of title III of the Social Security Act.

The State of Illinois argued the base period is not a method of administration, but an eligibility criterion which is a matter of State discretion. The Department of Labor filed an amicus brief in the case supporting Illinois interpretation of the law.

The U.S. Court of Appeals reversed the decision of the district court. The U.S. Court of Appeals found the base period is an administrative consideration within the meaning of title III of the Social Security Act.

The district court, upon remand, subsequently held that given the delay in eligibility determination caused by Illinois base period, the State's base period did not ensure the greatest promptness that is administratively feasible in paying UI.

The court of appeals' decision applies only to the States of Illinois, Indiana, and Wisconsin. The district court's decision applies in Illinois. However, these cases could serve as a precedent in other cases.

Subsequent to these decisions, the Advisory Council on Unemployment Compensation completed its comprehensive examination of the UI system. The Council explored issues in the UI system that it believes should be addressed as we move into the next century, including issues relating to low-wage workers, part-time workers, and workers and their work arrangements connected to the labor force.

With respect to alternative base periods, the Advisory Council recommended that the States use an alternative base period when necessary to qualify claimants for benefits.

As a followup to the Council's work, we in the Department of Labor have initiated research regarding a number of issues raised by the Council. Included in this research effort is research on alternative base periods.

We commissioned in 1994 a study to examine the effects of alternative base period arrangements that exist in six States currently.

The study, while it has been limited in scope, does suggest some findings for alternative base periods: First, that increases in the number of monetarily eligible claimants, especially among low-wage and part-time workers, would accrue under alternative base periods; that under alternative base periods, you would raise the number of monetarily eligible claimants by 6 to 8 percent. This would have a notable effect on UI benefit outlays and increase in costs of about 4 to 6 percent and, in the short run, reduce Unemployment Trust Fund balances. Alternative base periods also entail additional administrative costs.

In June 1995, we again commissioned additional research on the impacts of alternative base periods. This research is scheduled to be completed in May of next year, and this will add to previous work.

Among other things, we are analyzing and developing a means to assess the impact of alternative base periods on trust funds over time, determining the implementation and ongoing administrative cost for States, and estimating the administrative cost to employers.

We are aware of the impact of various base periods on access to the unemployment insurance system. We want to gain some further knowledge through our research efforts. We are also aware of the ramifications for States of the *Pennington* court decision. However, we believe that the legislation to amend title III to address the *Pennington* issues would be premature at this time.

Illinois has appeal rights at its disposal, as well as the ability to establish an alternative base period on its own as other States have done by changing its UI law. It is a choice for Illinois at this point or any State's choice on how to balance the various pros and cons of immediate access for claimants versus a demonstrated attachment to the labor force.

The real issue for the unemployment insurance system is not the definition of a base period, per se, but the broad question of access to the UI system. We would encourage States to consider seriously changes that States could make to open their systems to those individuals who are truly attached to the work force, but are being denied access due to unexamined, outdated policies, but the Department will continue to work with States. We would also like to continue the research underway on alternative base periods.

This concludes my formal remarks, Mr. Chairman. We look forward to working with you, Subcommittee Members, and the States on making the UI system responsive to the needs of experienced workers whose access to benefits might be hindered by outdated policies.

Thank you.

[The prepared statement follows:]

STATEMENT OF RAYMOND J. UHALDE
DEPUTY ASSISTANT SECRETARY OF LABOR
EMPLOYMENT AND TRAINING ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

July 11, 1996

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify on the Pennington decision and its impact on the unemployment insurance program. I also want to introduce Mary Ann Wyrsch, Director of the Unemployment Insurance Service in the Department of Labor's Employment and Training Administration.

BACKGROUND

Before discussing the Pennington decision, I want to provide you with some background information on the matter at issue in that case, the establishment of base periods under the unemployment insurance program.

State unemployment insurance (UI) laws identify a base period for measuring the wages earned by an individual from employment that is covered under the unemployment insurance system. Earnings during the base period are then used as the basis for determining whether the individual qualifies for unemployment benefits, the weekly benefit amount, and the duration of such benefits.

The date establishing the beginning and ending of the base period depends on when the claimant first applies for benefits or first begins drawing benefits. In all States the base period is comprised of four quarters or a 52-week period. Most States (47) define the base period as the first four of the last five completed calendar quarters immediately preceding the first day of an individual's "benefit year." (The "benefit year" is the period in which rights to unemployment benefits based on the claimant's base-period employment may be exercised.) Two States use as the base period the 52 weeks preceding the benefit year, two States use the last four quarters, one State uses the four quarters ending four to seven calendar months before the benefit year, and one uses a uniform calendar year.

In addition to the primary base period, seven States presently provide for alternative base periods (ABPs) if the claimant does not meet qualifying requirements using the primary base period. Generally, this ABP is the last four quarters preceding the filing of the claim.

The interval between the end of the base period and the beginning of the benefit year -- the lag period or quarter -- is intended to allow time for the recording of the base-period wages necessary to establish a benefit year, prior to the beginning of such year. In States using the first four quarters, the lag is three to six months; in States using the last four quarters, the lag is less than three months. While initially a long period of time was necessary to collect and post wage information, technology has reduced the amount of time needed to do so. All wages in covered (insured) employment earned during the base period -- regardless of the number of different employers -- are used in determining qualification for benefits.

There are several advantages to claimants in using the most recent wages possible. First, recent wages tend to be higher and therefore, the benefit entitlement (both the amount and the duration) could be higher. Second, some claimants may have recent employment, but may not have wages reaching back five

quarters and therefore, would not have sufficient wages to qualify. While there is nothing to prevent the claimant from waiting until the subsequent quarter to file a claim, during the interim, the claimant may not have income support. The delay can be up to six months and may create financial hardships, particularly for low-wage and part-time workers.

PENNINGTON CASE

In Pennington, a claimant who was denied unemployment benefits because she did not have sufficient wages during the base period, filed suit in Federal court in July 1985 claiming that Illinois' base period was inconsistent with Federal law. The plaintiff argued that the base period violated section 303(a)(1) of Title III of the Social Security Act (SSA) which requires:

> "such methods of administration...as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due." (Emphasis added.)

The State of Illinois argued that the base period is not a method of administration, but an eligibility criterion which is a matter of State discretion. The Department of Labor filed an amicus brief in the case, supporting Illinois' interpretation of the law.

While the District Court ruled in favor of Illinois in October 1992, the U.S. Court of Appeals (7th Circuit) reversed the decision. The Court of Appeals found that the base period is an administrative consideration within the meaning of Title III of the Social Security Act and remanded the case to the District Court for determination of whether the Illinois base period satisfies the "when due" requirement of Federal law.

The District Court subsequently held that, given the delay in eligibility determinations caused by Illinois' base period, the State's base period did not insure the greatest promptness that is administratively feasible in paying UI. The Court's decision permanently prohibits Illinois from applying its base period -- the first four of the last five completed calendar quarters -- to the Pennington class claimants -- those ineligible due to insufficient earnings during the base period.

The Court of Appeals decision applies only to States in its circuit: Illinois, Indiana, and Wisconsin. The District Court's decision applies only to Illinois. However, these cases may serve as precedent in the event other cases arise.

ADVISORY COUNCIL ON UNEMPLOYMENT COMPENSATION

The Advisory Council on Unemployment Compensation earlier this year completed its comprehensive examination of the UI system. The Council explored issues in the UI system that it believed should be addressed as we move into the next century — including issues related to low-wage and part-time workers.

With respect to alternative base periods (ABPs), the Council recommended that States use an ABP when necessary to qualify claimants for benefits. As follow-up to the Council's work, we have initiated research regarding a number of issues raised by the Council. Included in this effort is research on ABPs.

RESEARCH ON ALTERNATIVE BASE PERIODS

The Employment and Training Administration (ETA) commissioned in 1994 a study to examine the effects of ABP arrangements that exist in six States. The study, while limited in scope, suggests that an alternative base period:

- Increases the number of monetarily eligible claimants -- especially among low-wage and part-time workers;
- Raises the number of monetarily eligible claimants by six to eight percent;
- Has noticeable effects on UI benefit outlays -- an increase in costs of four to six percent -- and short-run effects reducing unemployment trust fund balances;
- Entails additional administrative costs.

In June 1995, ETA commissioned additional research on the impacts of alternative base periods. This research -- scheduled for completion in May 1997 -- will build on previous work. Among other things the contractor will analyze and develop a means to assess the impact of ABPs on trust funds over time, determine implementation and ongoing administrative costs for States, and estimate administrative costs to employers.

DEPARTMENT OF LABOR POSITION

We are aware of the impact of various base periods on access to the UI system, and we want to gain further knowledge through our research efforts. We also are aware of the ramifications for States of the Pennington court decision. However, we believe that legislation to amend Title III to address the Pennington issue would be premature at this time. Illinois has appeal rights at its disposal as well as the ability to establish an ABP on its own -- as other States have done -- by changing its UI law. It is Illinois' choice, or any State's choice, of how to balance the various pros and cons of immediate access versus demonstrated attachment to the labor force.

The real issue for the UI system is not the definition of a base period per se, but the much broader question of access to the UI system. We would encourage States to seriously consider changes to open their systems to those individuals who are truly attached to the workforce, but are being denied access due to unexamined and outdated policies.

The Department will continue to work with States, and we also will continue the research underway on the alternative base period concern.

This concludes my formal remarks. We look forward to working with you and subcommittee members -- and States -- on making UI systems responsive to the needs of experienced workers whose access to benefits is hindered by out-dated policies.

Chairman SHAW. Thank you for your testimony.

Ms. Wyrsch, did you have testimony or are you accompanying Mr. Uhalde?

Ms. WYRSCH. No, I do not.

Chairman SHAW. Our next witness was introduced by Congressman Crane, the comptroller of the State of Illinois, Ms. Didrickson.

Am I pronouncing that right?

Ms. DIDRICKSON. Didrickson. That is correct.

Chairman SHAW. Yes, OK. Fine.

STATEMENT OF HON. LOLETA A. DIDRICKSON, COMPTROLLER, STATE OF ILLINOIS

Ms. DIDRICKSON. Well, good morning, Mr. Chairman.

Chairman SHAW. I would like to ask all the witnesses, if you could, the lights that are on the table are set for 5 minutes. If you could kind of keep an eye on them. I am not going to be too strict with the gavel, but if you could keep an eye on it. When the red light comes on, it means that the time has expired.

Proceed as you wish, please.

Ms. DIDRICKSON. Thank you, Mr. Chairman and Members of the Subcommittee.

On behalf of Governor Jim Edgar and myself, as the comptroller of the State of Illinois, I thank you for the opportunity to testify.

I am asking for your help in passing the legislation that Congressman Phil Crane will be introducing later this afternoon in order to overturn the Federal appellate court decision in *Pennington* v. *Jackson*, *Pennington* v. *Didrickson*, and now *Pennington* v. *Doherty*.

When I served as director of the Department of Employment Security, it was obvious to us at the department that this case was not only pivotal to the definition of unemployment insurance law, but it had serious financial implications to our State and Federal Government, as well as to the employer community.

The interpretation of the appellate court decision will result in an overall shift in the intent of unemployment insurance representing a 180-degree departure from how the Federal Government and States have really defined the Social Security Act since its inception, more than 60 years ago.

The blueprint for today's unemployment insurance system was intended for unemployment insurance benefits to be limited to individuals who are ordinarily steadily employed, not to provide relief simply for anyone who is out of work. In other words, it wasn't designed to be a welfare program financially supported by employers. It is an insurance program.

Pennington is a class-action lawsuit which is challenging Illinois base period, as you just heard. The period of time reviewed to determine whether an individual has earned enough to qualify for unemployment insurance. The base period also determines the amount of the individual's weekly unemployment check.

Virtually all States define the base period in the same way as Illinois, I believe about 49 States, using the first four of the last five completed calendar quarters preceding the individual's filing an initial claim.

Now, the plaintiffs in *Pennington* maintain that Illinois base period violates the Social Security Act's "when due clause." They argue that anyone who is not monetarily eligible using Illinois base period should be able to establish eligibility through an alternative base period using the last four quarters.

I don't believe that Congress intended to preempt States rights with this. Contrary to arguments by both the U.S. Department of Labor and the State of Illinois, the Seventh Circuit Appellate Court ruled that Illinois base period could be challenged under the "when due clause" and returned the case to district court to determine whether the Illinois base period violated the Federal provision.

The appellate court instructed the district judge to weigh the benefits of individuals filing unemployment insurance claims using the alternate base period against the State's interest in holding down those administrative costs and minimizing fraud.

On remand, the district judge determined the claimant's interest outweighed our State's interest, and Illinois was to adopt the alternate base period.

The appellate court's decision on *Pennington* v. *Didrickson* contradicts legislative history and Supreme Court precedent. It also defies the U.S. Department of Labor's longstanding reading of the Social Security Act in giving States flexibility to establish their own eligibility criteria. It calls on appointed Federal judges to make a policy judgment, the types of decisions that State and local officials elected by the people are better suited to make.

The appellate court's ruling separates the authority to make policy decisions from accountability for those decisions, and the financial implications are far reaching. In fact, not only does this case have an impact on administrative cost and increased Federal funding from your perspective, it impacts those who make up the backbone of our economy in Illinois, our employers. Clearly, *Pennington* would hike State government's cost of doing business.

When the case was remanded back to the district judge, he noted the administrative cost to Illinois probably using the alternate base period. It is going to cost us somewhere from $12 to $15 million one time plus $2.5 million every year thereafter.

The judge also acknowledged that the Federal Government—the Federal dollars to cover those costs were not likely to be provided.

Pennington could substantially raise outlays from Illinois Unemployment Trust Fund account and impose hefty increases on our employers in terms of their taxes.

The Illinois Department of Employment Security estimates the alternate base period would increase Illinois trust fund outlays by 1.5 percent.

A U.S. Department of Labor study indicates alternate base periods raise State trust fund outlays by 4 to 6 percent.

Let us just talk about a 1.5-percent increase in outlays from Illinois trust fund account. It would amount to more than $180 million over the next 8 years, or on an annual basis, that is $22 million in the State of Illinois.

If I use the Federal Department of Labor's 6-percent increase, the total is $750 million. Now we are talking $93 million annually.

Since State trust fund accounts are part of the unified Federal budget, as you are aware, the difference between the increased out-

lays and the higher taxes would translate into an increase in the Federal deficit, a more than $100-million increase if outlays rose by 1.5 percent, or using that 6 percent, a $400-million increase.

To maintain an adequate trust fund balance with the additional outlays resulting from this decision, employers would be forced to pay higher unemployment insurance taxes. It probably would result in nearly a $70-million tax increase over the 8-year period using that 1.5 percent.

If I use the 6 percent, now you are looking at employer taxes increasing $350 million over that 8-year period.

Let me just kind of go through that because I see the red light is on. Really, my specific request to you is for an amendment to the "when due clause," as I understand Congressman Crane is going to be introducing.

We are a very rich, vibrant Nation, but how we can truly be ready to meet the economic challenges of the next century is to make certain that our business community is not unfairly saddled with hundreds of millions of dollars of new taxes.

In closing, I would just like to thank you for your time and consideration and also refer to the previous testimony from the Department of Labor that said that Illinois has the choice. The fact of the matter is that we do not have a choice in terms of being able to get out from underneath this *Pennington* decision, the U.S. Appellate Court decision that has been filed against us in the State of Illinois.

It is a tremendous cost for us. We once before tried to go before the U.S. Supreme Court with 23 other States and were denied. We don't really see the fact that the court system is going to be able to allow us to be able to have our own States rights here in terms of eligibility, and so that is why we are looking to the U.S. Congress.

Thank you very much.

[The prepared statement follows:]

TESTIMONY
BEFORE THE HUMAN RESOURCES SUBCOMMITTEE,
HOUSE WAYS AND MEANS COMMITTEE,
BY
THE HONORABLE LOLETA A. DIDRICKSON,
COMPTROLLER OF THE STATE OF ILLINOIS,
ON BEHALF OF
THE HONORABLE JIM EDGAR,
GOVERNOR OF THE STATE OF ILLINOIS

July 11, 1996

Thank you, Mr. Chairman and members of the Subcommittee, for the opportunity to testify before you today. I am here to ask for your help in passing legislation to overturn the federal appellate court decision in *Pennington v. Didrickson.* That decision represents a 180-degree departure from the manner in which both the federal government and states have construed the Social Security Act, since that statute's enactment more than 60 years ago. It also vests unelected federal judges with policy making authority that should properly be reserved to elected officials. Left standing, it could soon have a costly impact upon employers and state government in Illinois and aggravate the federal deficit by hundred's of million's of dollars. Its impact could ultimately be compounded across the nation.

Background - State Base Period

Pennington is a class action lawsuit, challenging the provision of Illinois law that establishes the state's "base period." As you know, the base period is the period of time examined to determine whether an individual has earned enough wages to be eligible for unemployment insurance and, if so, the amount of the individual's weekly unemployment check. The base period in Illinois is the first four of the last five completed calendar quarters preceding the individual's filing an initial claim. To qualify for unemployment insurance in Illinois, an individual must have been paid at least $1,600 in wages during his or her base period, with at least $440 having been earned outside the quarter in which the individual's wages were highest.

Forty-nine other jurisdictions use the same base period as Illinois. Of those, eight have adopted alternate base periods for individuals who do not qualify using the standard base period. There are two reasons for the nationwide prevalence of the base period Illinois uses.

First, a base period of the first four of the last five quarters generally ensures that unemployment insurance will be available for workers with a genuine attachment to the labor force, but not necessarily for those with only a marginal connection.

The legislative history of the Social Security Act indicates that unemployment insurance was intended to be limited to individuals with established ties to the workforce. According to a 1935 report by the Committee on Economic Security, which drew the blueprint for today's unemployment insurance system, unemployment insurance was intended for the "ordinarily steadily employed." The Ways and Means Committee's report on the Social Security Act noted the program was not intended to provide relief for everyone who was out of work.

Congress' intent still makes sense today. Unemployment insurance is funded almost exclusively by employers. In Illinois, it is funded 100 percent by employers. Employers alone should not bear the burden for individuals with little or no attachment to the world of work.

Second, a base period like Illinois' streamlines administration and minimizes the risk of fraud. Within a month following the close of each quarter, Illinois employers provide the state with reports on the wages paid to their workers during that quarter. The state uses those reports to verify that claimants are monetarily eligible for unemployment insurance. With Illinois' base period, all reports needed to verify an individual's eligibility should already be in the state's computer system when the initial claim is filed.

Pennington Lawsuit

The plaintiffs in *Pennington* are arguing that Illinois' base period violates the Social Security Act's "when due clause." The plaintiffs maintain that anyone who has not earned $1,600 over the 12 months included in the base period, or has not earned $440 outside the high quarter, should be able to try to establish eligibility through an alternate base period using the last four quarters.

When the case was first heard in district court, the judge agreed with Illinois that, as part of the state's monetary eligibility requirement, Illinois' base period could not be challenged under the Social Security Act. However, the appellate court reversed and remanded the case, to determine whether the Illinois base period violated the "when due clause."

To make that determination, the appellate court instructed the district judge to balance the benefits which some claimants could derive from the alternate base period against the state's interest in holding down administrative costs and minimizing fraud. On remand, the district judge determined the claimants' interests outweighed the state's and, therefore, that Illinois had to adopt the alternate base period. Illinois has again appealed.

With all due respect, I submit the appellate court was wrong, for a number of reasons. The legislative history of the Social Security Act indicates Congress intended states to have broad freedom to set up the types of unemployment insurance systems they considered appropriate.

The United States Supreme Court has held that the Social Security Act was intended to recognize the importance of each state establishing its own eligibility criteria for unemployment insurance.

In addition, since the establishment of the unemployment insurance system, the Labor Department - the federal agency charged with enforcement of the "when due clause" - has considered a base period of the first four of the last five quarters to be consistent with the clause and, in fact, has suggested that the states use such a base period.

In the 1970's, Congress itself expressly recognized and took no issue with the states' widespread use of base periods consisting of the first four of the last five quarters.

Beyond all that, however, the appellate court was wrong because the balancing test it prescribed is essentially a policy judgment of the type that governors and state legislatures are elected to make and are better-suited to make. The appellate court's ruling has separated the authority to make policy decisions from accountability for those decisions, with potentially expensive consequences.

Potential Illinois Impact of *Pennington*

In deciding the case on remand, the district judge noted that the administrative costs of the alternate base period could be substantial - $12 million to $15 million in one-time costs and $2.5 million in additional yearly operating expenses according to the Department of Employment Security. He also acknowledged that additional federal dollars to cover those costs were not likely to be forthcoming. He did not, however, concern himself with where the money to cover those costs would come from or with any of the other significant implications of what the plaintiffs want.

In fact, in addition to hiking state government's costs of doing business, *Pennington* could substantially raise outlays from Illinois' Unemployment Trust Fund account and impose hefty increases in employer taxes.

The Department of Employment Security estimates the alternate base period the plaintiffs are seeking would increase Illinois' Trust Fund outlays by 1.5 percent. A Labor

Department study indicates alternate base periods raise state Trust Fund outlays by four to six percent. A 1.5-percent increase in outlays from Illinois' Trust Fund account would amount to more than $180 million over the next eight years, a six-percent increase would total $750 million.

As state law is currently written, additional outlays would automatically trigger tax increases for Illinois business. A 1.5-percent increase in outlays would result in nearly a $70-million tax increase. A six-percent increase in outlays would raise employer taxes by $350 million.

Since state Trust Fund accounts are part of the unified federal budget, the difference between the increased outlays and the higher taxes would translate into an increase in the federal deficit - a more than $100-million increase if outlays rose by 1.5 percent; a $400-million increase if outlays rose by six percent.

Moreover, determining eligibility based on wages earned after the first four of the last five quarters would entail either essentially taking a claimant's word for it as to the amount of those earnings, thereby increasing the risk of fraud, or requiring additional reporting from employers to verify the earnings, thereby imposing new "paperwork burdens."

Potential National Impact of Pennington

Pennington's impact in Illinois, including its effect on the federal deficit, could presage things to come for nearly every other state. The appellate court's decision is binding in Indiana and Wisconsin, as well as Illinois, and can be used as precedent to attack other states' unemployment insurance laws. Moreover, *Pennington's* use as precedent will not necessarily be limited to cases where an alternate base period is the difference between eligibility and ineligibility. States can expect the argument that the "when due clause" requires an alternate base period when an alternate base period would yield a higher weekly benefit check. *Pennington* has blurred the line between what a state can and cannot be sued for under the "when due clause."

In the friend-of-the-court brief it submitted to the appellate court, the Labor Department said, "Given the widespread use of the type of base period employed by Illinois, an order striking down the Illinois law undoubtedly would cause nationwide disruption in the various states' unemployment compensation systems."

The case's implications beyond Illinois' borders prompted 23 states to join Illinois in requesting Supreme Court review of the appellate court's decision.

Conclusion

The type or number of base periods a state uses is not the litmus test of the fairness of that state's unemployment insurance system. It is simply a reflection of how that state's policy makers have decided to allocate the system's limited resources to best serve the interests of everyone whom the system was established to serve.

My specific request to you is for an amendment to the "when due clause" to clarify the Social Security Act does not govern state base periods. The amendment will eliminate the need for further costly litigation. Consistent with the intent of the unemployment insurance system's architects, it will also ensure that requirements as to eligibility remain a decision for state policy makers, who are directly accountable to the people who will be impacted by that decision.

I look forward to working with you toward a speedy resolution of this issue.

Thank you again for your time and consideration.

Mr. CAMP [presiding]. Thank you very much.

Now we will hear from Andrew Richardson, commissioner of the West Virginia Bureau of Employment Programs.

STATEMENT OF ANDREW N. RICHARDSON, COMMISSIONER, WEST VIRGINIA BUREAU OF EMPLOYMENT PROGRAMS; ON BEHALF OF THE INTERSTATE CONFERENCE OF EMPLOYMENT SECURITY AGENCIES

Mr. RICHARDSON. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Andy Richardson. I am the commissioner of the West Virginia Bureau of Employment Programs. I am a past president of ICESA, the Interstate Conference of Employment Security Agencies. I am here in that capacity. ICESA is the national organization of the State officials who administer the employment security system which includes the unemployment compensation programs, the job service offices across the United States, labor market information, and in most States the job training programs as well.

I would like to thank Chairman Shaw and the staff and Members of the Subcommittee for inviting ICESA to present our views today. I would commend my written statement for your review, and I will summarize some of my thoughts here verbally in the interest of time.

I believe this particular issue strikes at the very heart of the very unique Federal-State relationship that the Nation's unemployment system has experienced since its creation in the thirties.

The Federal law, the Social Security Act, defers to the States to determine eligibility requirements for unemployment compensation benefits. An individual must have sufficient wages preceding the filing of a claim to demonstrate a sufficient attachment to the labor force in order to qualify for this insurance program.

That period is called the base period. In most States, that is, in fact, the first four of the last five completed calendar quarters. The wages that you have earned during that period will determine the amount of your unemployment benefits and how long they will be available.

For example, if you filed a claim today, July 11, 1996, your base period would be April 1, 1995, through March 31, 1996.

Even if they had worked all the period of time from April 1, 1995, right up through yesterday, that would be the period of time looked at, and it is a very predictable, manageable concept.

The legislative framework that created the unemployment system is the Social Security Act of 1935, and it gave States broad discretion in the establishment of their unemployment programs, including the terms and conditions under which benefits are payable.

Now, through the history of this program, determining the period that constitutes the base period for eligibility for unemployment compensation has been one of the many eligibility criteria that the Federal law has deferred to the State governments.

It is remarkable, really, that the structure of the State programs is very similar. Most States, in fact, do use the first four of the last five calendar quarters for the base period.

Why? Well, when they set up the system nationally in the thirties, draft legislation was prepared for the States by the Federal

Government, and that legislation became the genesis of virtually every unemployment compensation law across the United States. So the Federal Government provided all the States with draft legislation saying here is the way to comply with the Federal law.

Now we have the *Pennington* case coming along saying that that very concept of legislation that was provided in a model format for the States is not correct, and instead of using this framework to defer to the States on how to determine when meeting the "when due clause," we now have this different approach being proposed.

The view of the Interstate Conference of Employment Security Agencies is that this is a matter to be left to the States. We don't oppose alternative base periods. In fact, many States have opted to do that across the country. Most States, however, do use the first four of the last five quarters. Some States use more recent wages for qualifying purposes.

ICESA believes that States should continue to have latitude to establish such alternatives or other standard base periods—that the first four of the last five calendar quarters is only one of a variety that the States choose to use.

We are concerned that the *Pennington* case could establish a precedent for the determination of other qualifying and eligibility requirements for State unemployment benefits by the judicial rather than the legislative process.

Expansion of the court's authority in setting qualifying and eligibility requirements for unemployment benefits preempts the democratic process and, as a result, is likely to erode public support for the program.

For example, some States choose to make certain decisions relative to payment of unemployment compensation. What constitutes a just cause for quitting? Are we now going to have the court system direct us that certain things are a just cause for quitting and you, therefore, must pay unemployment compensation benefits?

This is a substantial encroachment into the deference to the States and the design of these programs, and the recommendation of the Interstate Conference of Employment Security Agencies is that it is in the best interest of this very precious national system, this unique Federal-State relationship in the Unemployment Insurance Program, the workers it serves and the employers it serves to maintain the historical interpretation of the Social Security Act's "when due clause"; that that interpretation would be substantially changed if the *Pennington* decision stands, and therefore, ICESA urges you to enact legislation making it clear that congressional intent is to leave establishment of base periods up to the States.

Thank you very much for the opportunity to be with you today. I would be happy to respond to any questions.

[The prepared statement follows:]

STATEMENT
BY
ANDREW N. RICHARDSON
COMMISSIONER
WEST VIRGINIA BUREAU OF EMPLOYMENT PROGRAMS
ON BEHALF OF THE
INTERSTATE CONFERENCE OF EMPLOYMENT SECURITY AGENCIES
TO THE
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON HUMAN RESOURCES
JULY 11, 1996

Mr. Chairman and members of the Subcommittee, my name is Andy Richardson. I am Commissioner of the West Virginia Bureau of Employment Programs, and I am here today representing the Interstate Conference of Employment Security Agencies (ICESA). ICESA is the national organization of state officials who administer the nation's public Employment Service, unemployment insurance laws, labor market information programs and, in most states, job training programs.

I would like to thank Chairman Shaw for the invitation to present ICESA's views about the federal court's ruling in the Pennington case.

Background

To establish eligibility for unemployment benefits, an individual must have sufficient wages preceding the filing of a claim. The period surveyed for these wages is called the "base period."

Most states use a base period consisting of the first four of the last five completed calendar quarters. For example, if the claim were filed today, July 11, 1996, the base period would be April 1, 1995, through March 30, 1996. Even if the individual had worked during all of the period from April 1, 1996, through July 10, 1996, the wages from this work would not be used to determine eligibility for a claim.

The first four of the last five completed calendar quarters is the most common base period. It reflects the public policy judgement that unemployment benefits should be paid only when the claimant has an established attachment to the labor force. In addition, almost all states determine eligibility for benefits using wage information which is reported by employers on a quarterly basis for all workers. It takes time for these reports to be completed and submitted by employers and for states to enter the information into state computer databases.

Outline and Status of the Pennington Case

As you know, the plaintiffs in Pennington are a class of claimants who were not monetarily eligible for unemployment benefits using the standard Illinois base period but would have been eligible had earnings subsequent to the first four of the last five quarters been considered. They contend that the Illinois base period violates the Social Security Act's requirement that administrative methods ensure that UI benefits are paid "when due."

In 1994, the Seventh Circuit Court of Appeals reversed the district court and ruled that the base period provided for by the Illinois Unemployment Insurance Act is an "administrative provision" subject to the "when due" clause. The appellate court remanded the case to the district court for a determination as to whether the "when due" clause had been violated. To make the determination, the district court was instructed to balance the plaintiffs' interest in prompt payment of benefits against the state's interest in minimizing administrative costs and preventing fraud. The U.S. Department of Labor submitted an *amicus* brief to the court supporting the Illinois Department of Employment Security's position that the base period is an eligibility requirement, not an administrative method, and accordingly, not subject to the "when due" clause. The court appeared to give little weight to the Labor Department's arguments because the department has not issued regulations on the matter.

The Illinois DES appealed the seventh circuit's ruling to the Supreme Court which declined to hear the case in November 1994 and remanded the case to the district court. Twenty-three states signed an *amicus* brief supporting Illinois' position.

On remand, the district court weighed four factors: 1) the number of additional eligible claimants there would be under an alternative base period; 2) the amount of additional benefits that would be paid; 3) the increased promptness with which eligible claimants would receive benefits; and, 4) the administrative costs of implementing an alternative base period. There was no consideration of the potential impact on employers in terms of additional costs or administrative burden. With respect to administrative costs, the court found IDES' evidence credible--the agency would incur more than $13 million in one-time costs and additional annual operating expenses of more than $2.5 million. The court also stated it was likely that federal funding to cover the costs would not be forthcoming. Nevertheless, the court concluded that the first three factors inured to the plaintiffs' benefit and outweighed the fourth. Accordingly, Illinois' base period was held to violate the "when due" clause.

ICESA's Views

Our nation's unemployment insurance (UI) system is a unique federal-state partnership, grounded in federal law but executed through state law by state officials. The legislative framework created with the Social Security Act in 1935 gives states broad discretion to design their own unemployment insurance programs including determining the terms and conditions under which benefits are payable.

Prior to the court's interpretation in Pennington, Section 303 (a) (1) has been interpreted by the Executive Branch and by the courts since 1935 to mean that benefits should be paid as promptly as is feasible administratively under the terms and conditions of state laws.

Throughout the history of the unemployment insurance program, determining the period that constitutes the base period for unemployment insurance claims purposes has been one of many eligibility criteria that federal law has left to the states. For example, each state--through its legislative process--decides the amount of earnings necessary to qualify for benefits, whether various reasons for voluntarily leaving a job constitute "good cause" and when the reasons for discharge from a job are such that an individual is disqualified from benefits.

The legislation establishing the unemployment insurance system in this country makes it clear that Congress intends for the states to have wide latitude in designing their unemployment compensation programs. That being the case, it is remarkable that the structures of state programs are so similar. This phenomenon can most likely be traced back to "draft bills" for state unemployment compensation laws that were provided to the states by the Department of Labor to illustrate legislation that would meet federal requirements. The base period that Illinois and most other states use was included in a draft bill that many states used as a model for their respective state laws. Therefore in establishing a base period consisting of the first four of the last five completed calendar quarters, states were assured that their law conformed to federal requirements. In addition, each year the Secretary of Labor must certify to the Secretary of the Treasury that each state's unemployment compensation law is in conformity with federal law in order for employers doing business in the state to claim the 90% offset credit against federal unemployment tax obligations. The Secretary has certified the Illinois law and the laws of other states with the same base period structure for almost 60 years.

We believe that the court's decision in Pennington is an implausible interpretation of the Social Security Act's requirement that administrative methods be designed to ensure the prompt payment of benefits when due and is inconsistent with the intent of Congress that states have wide latitude to design state unemployment insurance programs.

A number of states have put alternative base periods in place to address the circumstances of the plaintiffs in Pennington -- individuals who would not qualify using the first four of the last five quarters but who would qualify if more recent wages were used. ICESA believes that states should continue to have latitude to establish such alternatives or other standard base periods -- that the first four of the last five quarters is only one of a variety of base periods that states might use. As technology that permits states to collect and process wage information more quickly becomes available, more states may wish to establish alternatives or more recent quarters as their base periods. However, purchasing the latest technology and implementing alternatives to standard practices are expensive. Administrative funding for unemployment insurance was cut about 6% in FY 1996, and increases in the future to support practices such as alternative base periods does not appear likely.

As you know, administrative funding for unemployment insurance is included under domestic discretionary spending caps although the program is an entitlement. There is currently no provision for increases in administrative funding for unemployment insurance under the discretionary caps--even though the number of beneficiaries who would be entitled to be served could increase substantially in an economic downturn.

Implications

The Pennington decision blurs the line between what is an eligibility requirement and what is an administrative method, potentially giving rise to further lawsuits against state employment security agencies regarding issues beyond base periods. We are concerned that Pennington could establish a precedent for determination of other qualifying and eligibility requirements for state unemployment benefits by the judicial rather than the legislative process. Expansion of the courts' authority into setting qualifying and eligibility requirements for unemployment benefits preempts the democratic process and, as a result, is likely to erode public support for the program.

In the legislative process, discussions about qualifying and eligibility are not an entirely intellectual exercise. The practical implications, as well as the intellectual basis, of new provisions must be recognized because the legislative body bears responsibility for the outcome. For example, in a state where individuals in the same circumstances as the plaintiffs in Pennington are not eligible for benefits, legislators must explain to constituents why they are not eligible; in a state where an alternative base period is put in place, legislators must explain to their employer constituents that their unemployment taxes will be higher. In the legislative process, all interests must be weighed. The courts simply issue an opinion and take no responsibility for implementation.

Recommendation

We believe that it is in the best interest of the unemployment insurance system and the workers and employers it serves to maintain the historical interpretation of the Social Security Act's "when due" clause; that interpretation would be changed significantly if the Pennington decision stands. ICESA urges you to enact legislation making clear Congressional intent to leave establishment of base periods to the states.

Mr. CAMP. Thank you.

First, before we go to questions, we will hear from Albert Miller, president of Phoenix Closures, Inc.

STATEMENT OF ALBERT R. MILLER, PRESIDENT AND CHIEF OPERATING OFFICER, PHOENIX CLOSURES, INC., NAPERVILLE, ILLINOIS

Mr. MILLER. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Bert Miller, and I am the president and chief operating officer of Phoenix Closures. My company is located in Naperville, Illinois, and produces container caps for regional and national brands, both domestic and international. Our customers cover a variety of markets including foods, household chemicals, cosmetics, health care products, industrial products, and pharmaceuticals.

Phoenix Closures presently employs more than 200 workers and has been an Illinois employer for over 100 years.

I am here today to express my strong support for the legislation Governor Edgar and Comptroller Didrickson are seeking in connection with the *Pennington* case. I also have a general observation regarding devolution of the employment security system.

As to *Pennington*, there are problems both with the alternate base period itself and the manner in which its proponents are trying to implement it.

The *Pennington* alternate base period would provide for the payments of unemployment benefits financed exclusively by employers to individuals with no established connection to the work force. To that extent, it would turn the unemployment insurance system into a 100-percent employer-financed welfare program, something well beyond what I understand to have been Congress' intent and something employers cannot afford.

Comptroller Didrickson has already discussed the estimates regarding the alternate base period's potential impact on the trust fund and employer taxes. A 1.5-percent increase in outlays would raise employer taxes by nearly $70 million over the next 8 years. A 6-percent increase would increase taxes by nearly $350 million over that period.

To put those numbers into context, let me talk briefly about my own company's situation. Phoenix Closure's sales for the year to date are up 30 percent over last year. However, rising raw material costs left the company's bottom line essentially unchanged. In an environment where output has to improve by nearly one-third just for business to stay even, the prospect of any tax increase is daunting. The possibility of a $350-million tax increase is absolutely staggering.

The alternate base period's cost to employers, however, would not necessarily be limited to higher tax. I understand employers would also be faced with the additional reporting requirements with penalties for noncompliance in the event they failed to verify claimant's earnings not yet in the State's computer system on a timely basis.

I am also troubled by the potential impact on government, $12 to $15 million in startup costs and $2.5 million in extra annual costs with no identifiable source to cover those costs.

I am no apologist for government. By and large, it needs to work a whole lot smarter and cheaper than it does now. However, we cannot realistically expect results if we just keep it doing more things.

The alternate base period takes us further in the wrong direction. It just gives government one more thing to do.

Having said all this, I recognize there are reasonable people who might disagree with me. I could probably have a spirited debate with them on the wisdom of an alternate base period. The problem is, as the *Pennington* case has transpired, most of my concerns will never enter into the debate.

According to the most recent district court decision, the only relevant considerations in deciding whether a State should adopt an alternate base period are how much more would be paid in benefits, and what the impact would be on government's operating expenses. The cost to employers in terms of higher taxes and additional paperwork simply won't count. Employers won't even be able to have the satisfaction of voting against the judge who made the decision.

Mr. Chairman, employers are the ones who pay for the system. Our concerns should at least be considered relevant to the discussion.

The legislation Illinois is asking for is simple. It will just make sure that the decision about whether the benefits of an alternate base period justify its cost remains one for policymakers who will be accountable to the people affected by the decision. It will also ensure that as the cost and benefits are weighed, all sides' concerns are given their due. I respectfully ask you to support it.

As to devolution, as with everything, the devil is in the details. However, done correctly, I believe it could make the employment security system more accountable to the people it serves, allow for more flexibility and smarter choices by State officials and make the system cheaper for government and employers. Your consideration of the matter will be a real service to employers and jobseekers alike.

Thank you very much for taking the time to hear my point.

[The prepared statement follows:]

TESTIMONY
BEFORE THE HUMAN RESOURCES SUBCOMMITTEE,
HOUSE WAYS AND MEANS COMMITTEE,
BY
ALBERT R. MILLER, PRESIDENT,
PHOENIX CLOSURES, INC.

July 11, 1996

Thank you, Mr. Chairman and members of the Subcommittee. My name is Bert Miller. I am the President and chief operating officer of Phoenix Closures. My company is located in Naperville, Illinois and produces container caps for regional and national brand products, both domestic and international. Our customers cover a wide array of markets, including foods, household chemicals, cosmetics, health care products, industrial products and pharmaceuticals. Phoenix Closures presently employs more than 200 workers and has been an Illinois employer for over 100 years.

I am here today to express my strong support for the legislation Governor Edgar and Comptroller Didrickson are seeking in connection with the *Pennington* case. I also have brief observations regarding the devolution of the employment security system.

As to *Pennington*, there are problems both with the alternate base period itself and the manner in which its proponents are trying to implement it. The *Pennington* alternate base period would provide for the payment of unemployment benefits, financed exclusively by employers, to individuals with no established connection to the workforce. To that extent, it would turn the unemployment insurance system into a 100-percent employer-financed welfare program - something well beyond what I understand to have been Congress' intent and something employers cannot afford.

By increasing outlays from Illinois' Trust Fund account, the alternate base period would also raise employer taxes. The greater the rise in outlays was, the higher the tax increase would be. The lowest estimate I have seen is that the alternate base period would increase outlays from Illinois' account by 1.5 percent. An increase of that size would raise employer taxes by nearly $70 million over the next eight years. There is a Labor Department study that estimates an alternate base period can raise a state's Trust Fund outlays by four to six percent. A six-percent increase in outlays from Illinois' account would raise taxes on Illinois business by $350 million over the next eight years.

To put those numbers into context, permit me to discuss briefly my own company's situation. Phoenix Closures' sales for the year to date are up 30 percent over last year. However, rising materials costs have left the company's bottom line essentially unchanged. In an environment where output has to improve by nearly a-third just for a business to stay even, the prospect of any tax increase is daunting. The possibility of a $350-million tax increase is absolutely staggering.

The alternate base period's cost to employers, however, would not necessarily be limited to higher taxes. I understand employers could also be faced with additional reporting requirements, with penalties for noncompliance, to verify claimant earnings that had not yet been reported and entered into the state's computers.

I am also troubled by the potential impact on government - $12 million to $15 million in start-up costs and $2.5 million in extra annual costs according to the Department of Employment Security, with no identifiable source to cover those costs. I am no apologist for government. By and large, it needs to work a whole lot smarter and cheaper than it does right now. However, we cannot realistically expect those results if we just keep giving it more things to do. The alternate base period takes us further in the wrong direction in that it just gives government one more thing to do.

Having said all this, I recognize there are reasonable people who might disagree with me. I could probably have a spirited debate with them on the wisdom of an alternate base period. The problem is, as the *Pennington* case has transpired, most of my concerns will never even enter into the debate. According to the most recent district court decision, the only relevant considerations in deciding whether a state should adopt an alternate base period are how much more would be paid in benefits and what the impact would be on government's operating expenses. The cost to employers, in terms of higher taxes and additional paperwork, will simply not count. Employers will not even be able to have the satisfaction of voting against the judge who made the decision. Mr. Chairman, employers are the ones who pay for the system; our concerns should at least be considered relevant to the discussion.

The legislation Illinois is seeking will simply make sure that the decision as to whether the benefits of an alternate base period justify its costs remains one for policy makers accountable to those who will be affected by the decision and that, as the costs and benefits are weighed, all sides' concerns are given their due. I respectfully ask you to support it.

As to devolution, as with everything else, the devil is in the details. However, done correctly, I believe it could make the employment security system more accountable to the people it serves; allow for more flexibility and smarter choices by state officials, and make the system cheaper for government and employers. Your consideration of the matter will be a real service to employers and job seekers alike.

Thank you for you taking the time to have this hearing today and for considering my views.

Chairman SHAW. Thank you.

Mr. McCrery.

Mr. MCCRERY. Mr. Richardson.

Mr. RICHARDSON. Yes, sir.

Mr. MCCRERY. Are you familiar with the holding in the *Pennington* case by the appeals court?

Mr. RICHARDSON. Yes.

Mr. MCCRERY. Can you explain it? In other words, what did the court say was wrong with having no alternate base period? Why isn't Illinois base period adequate?

Mr. RICHARDSON. I think it has to do with their interpretation of when benefits are due and the imposition of a very liberal interpretation of that concept to ensure that the most attractive way of paying the benefit is found for the unemployed worker.

To me, it rejects the consideration of the level of attachment to the work force, the attachment to the labor market that is sufficient for consideration of this insurance program.

Mr. MCCRERY. Give me an example of an alternate base period that the court would have you use.

Mr. RICHARDSON. An alternate base period example would be the four most recent completed calendar quarters, instead of the first four of the last five. I believe in the example I used, April 1, 1995, through March 31, 1996, would be the base period under the first four of the last five concept, if you were to file a claim today.

With an alternative base period, you would not only look at that, but you would look at July 1, 1995, through June 30, 1996, and whichever produced the best benefit for the unemployed worker would be the base period that you would use to determine the benefit amount.

Now, this is problematic for the States. To begin with, the wage reports for June 30, 1996, aren't even due in my State until the end of July. Now, I don't have that data. That means that I am going to have to request that last quarter from the employer in order to make that determination.

Now I request that. Now we get into some verification issues. We get into some accuracy issues. I think you raise the risk of increasing errors on the part of the payment processes. It could delay the payment of benefits while you are waiting to get that data from the employer.

Mr. MCCRERY. Mr. Uhalde, I gathered from your testimony that the Department of Labor's primary objection to legislation moving forward at this time is that it is premature. Is that correct?

Mr. UHALDE. That is correct.

Mr. MCCRERY. You don't have any problem with the substance of the legislation. I mean, are you in agreement still, as your amicus brief stated, that this should be a State's right to establish the base period?

Mr. UHALDE. The amicus brief that the Department filed was answering a very narrow question, and that was, Is the Illinois base period consistent with current law and regulations, and in our amicus brief we stated that in our opinion it was. That is our current interpretation, our present interpretation of the existing law.

The question that is being asked here is whether there ought to be legislation on that particular issue, and we think it is premature

probably for three or four reasons. One, we think there are appeal rights that currently exist, and I think it is important to get the court decision. We would have argued that the legislation is intended to correct, within the law, this one narrow interpretation, but that could leave open, then, what is primary State responsibility in other areas. This is a very narrow surgical legislative point.

Second, we now have some research ongoing, and legislative decision should be made with full information.

We have already heard that Illinois believes the cost would be about 1.5 percent. That also means benefits that people aren't getting is about 1.5 percent, but our preliminary analysis is that it could be as much as 6 percent.

Well, 6 percent in terms of benefits not paid to individuals, as well as 6 percent cost to the trust fund; that is quite a difference, and if we are going to legislate, we ought to legislate with the best information possible. In March, we will have pretty solid information on this question. We think it is reasonable to have such information.

Mr. MCCRERY. So, in other words, you are telling us today that even though the Department filed an amicus brief that you were filing the amicus brief strictly as a lawyer interpreting what you appreciated to be the current law, but if you were writing the law, you may arrive at a different conclusion. You may write a different law. You may not give the States the right to determine their own base periods. Is that correct?

Mr. UHALDE. Historically, our position has been that this issue is an eligibility issue, a determination of the States.

Mr. MCCRERY. Right.

Mr. UHALDE. That is correct.

Our position with regard to eligibility issues is unchanged—it is a position for the States, but there is a legitimate question; if you are going to change the Social Security Act and change the law now, then we should do this with full information. There isn't full information.

Mr. MCCRERY. Mr. Chairman, if you will indulge me just to continue this point.

Chairman SHAW. Yes, go ahead.

Mr. MCCRERY [presiding]. I am confused because you seem to be saying now that you are in agreement with the law as you interpret it, that this ought to be an eligibility issue and, therefore, determined by the States. If, in fact, that is your position, then why would you quarrel with legislation which would clarify the law?

Mr. UHALDE. Because we believe that at this point that is premature to be able to do.

Mr. MCCRERY. That brings us back to my original statement that your only objection is that it is premature.

Mr. UHALDE. I attempted to clarify why we believed that was premature in this instance.

Mr. MCCRERY. Again, if your only objection is that it is premature, I don't understand why. If we are willing to go through the trouble, it is no sweat off your back if we do the work and pass the bill. All you have to do is sign it. If we are willing to do the work to clarify the law to do what you say you think it should do, give the States the right to determine their eligibility periods or

their eligibility criteria, then I don't understand your objection. If we are willing to do the work and make the court case moot, basically, by making sure the interpretation of the law is clear along the lines that you think it should be, then I don't see that you should object to our moving forward.

Mr. UHALDE. We object because we don't think we ought to go forward without full information on this. We have quite a diverse understanding of what the impacts of this are going to be.

Our preliminary analysis is looking at the impact of people in filing in a static period over 1 year. We don't know, for example, how many of these individuals ultimately would have waited and filed anyway, so that these net benefit costs may be lower in this case. There are both costs to the system and to employers, but there are also benefits to individuals.

We stated our opinion in terms of the legal opinion, but I think if one is going to take the next step in terms of the legislation, the Congress as well as the administration ought to be informed.

We also think we can improve the system working with States using electronic filing to help reduce the lag period for individuals. We are working with States to be able to do that.

Mr. MCCRERY. OK. Well, thank you very much for responding to my questions.

Mr. Rangel.

Mr. RANGEL. Thank you. To the comptroller from Illinois, I assume the State opposes the decision that has been made in the *Pennington* case?

Ms. DIDRICKSON. That is correct.

Mr. RANGEL. I assume, further, that you are appealing that decision?

Ms. DIDRICKSON. We have. We have gone with 23 States all the way up to the U.S. Supreme Court after the decision by the U.S. District Appellate Court and were not successful. We've spent over half a million dollars to do that.

Illinois really has no choice.

Mr. RANGEL. I would assume, not having read your papers on appeal, that if you are successful then existing law will be what you, what the State will be guided by.

Ms. DIDRICKSON. If we are successful in appealing, right. But we have not been successful, there is a track record out there. And we have no choice.

Mr. RANGEL. What is going to happen?

Ms. DIDRICKSON. We went to the U.S. Supreme Court and were turned down and remanded back to the district court.

Mr. RANGEL. Have you exhausted your legal remedies?

Ms. DIDRICKSON. Other than the U.S. Supreme Court which we have already tried to appeal to, with 23 other States, and the case was not heard, we are currently back before the Federal appellate court.

Mr. RANGEL. So, would you support the Congress drafting legislation that would clarify this issue?

Ms. DIDRICKSON. Yes, we would. We see it as a preemption issue, 60 years ago, the question really is, Did Congress intend to preempt States rights? I think we've clearly heard that that wasn't the intent and we would like to be able to clarify that. Because, other-

wise, we are facing in the next year a potential $15 million cost in the State of Illinois and we don't know where we will get that $15 million. And that's just the administrative costs.

Mr. RANGEL. But you haven't the slightest clue what the Congress would come up, do you?

Ms. DIDRICKSON. Pardon me?

Mr. RANGEL. You have no idea what legislation we would come up with.

Ms. DIDRICKSON. I understand that Congressman Crane is introducing legislation this afternoon.

Mr. RANGEL. Well, it is generally true that when the Majority wants something done, the Minority does not have much influence. Under the normal way legislation is prepared you really don't know what will be signed into law.

My point, really, is that the Department of Labor indicated that they have an advisory council and there are a lot of recommendations out there that they support. As they've indicated today, the State would determine the base period. Since everyone does not agree with what you have said, that you have exhausted your legal remedies, that the best thing that could be served is that we get all of these people—Mr. Secretary, how long has your Department been working on this issue?

Mr. UHALDE. I believe the original case was filed in 1985.

Mr. RANGEL. No. I mean the revisions, the Council on Unemployment. Are you familiar with this?

Mr. UHALDE. Yes. And the Advisory Council has issued its report this year——

Mr. RANGEL. And these are experts?

Mr. UHALDE. Yes. This was a bipartisan commission appointed part by the administration, part by the Congress, both Majority and Minority and——

Mr. RANGEL. And so, the Congress will be best served if we just look at the basis of the recommendations. Most people believe that the States should control the base period. I don't think there is any disagreement out there.

And the question is, whether we do it on what makes us feel good, or act on the information of those people who specialize and recognize that there is a problem out there.

So, unless there's something urgent, is there anything urgent that any of the panel members feel——

Ms. DIDRICKSON. I think the question here is, you know, what is the benefit to waiting? And as I reread the Secretary of the Department of Labor's testimony here it is clearly stated. It is Illinois choice or any State's choice of how to balance the various pros and cons of immediate access versus demonstrated attachment to the labor force.

Mr. RANGEL. Well, let me ask the Secretary, do you believe that Illinois has exhausted its appeals rights?

Mr. UHALDE. No. We believe there is still an appeal right——

Mr. RANGEL. The Supreme Court?

Mr. UHALDE [continuing]. To the Supreme Court on this issue. I recognize that they have been not accepted once but we understand that could——

Mr. RANGEL. Well, you have no idea what this Congress will come up with if we come up with anything at all. And I hope that we might take into consideration all the available information based on studies, not to do what Illinois wants, but what is good for the entire Nation.

Illinois has seen what they perceive as States rights violated. I guess there is a lot of support for that. But I would assume, Secretary Uhalde, that this panel has discussed issues that go far beyond the Illinois court decision. Is that correct?

Mr. UHALDE. That's correct.

Mr. RANGEL. So, listen, we got a lot of things to do between now and the time we get out there to change this Congress. I would hope that we will just move on to something else and then when we get back in, we will do it the right way.

Mr. MCCRERY. Mr. Collins.

Mr. COLLINS. Good morning, Mr. Chairman.

Ms. Didrickson, as I understand though, you have not entered this case as just Illinois?

Ms. DIDRICKSON. That's correct.

Mr. COLLINS. There are how many other States involved?

Ms. DIDRICKSON. We had 23 other States that appealed with us to the U.S. Supreme Court when we were denied a hearing.

And, as you heard, Andy Richardson, who has testified on behalf of ICESA, all the other States, there's a very clear danger here that this legislation from the bench for Illinois is going to—and I believe the U.S. Department of Labor has also said—it's going to serve as precedent in other States.

So, there's a legal lawsuit pending right now, I understand, in the State of Washington and there are other States where similar action is pending.

Mr. COLLINS. And how many States have used this same criteria?

Ms. DIDRICKSON. My understanding is that there are 49 States.

Mr. COLLINS. And you're saying the danger here is that the Congress may not legislate but the bench may legislate.

Ms. DIDRICKSON. I'm saying that the bench has legislated.

Mr. COLLINS. Leaving very little of the voice of the people to be heard, just the bench.

Ms. DIDRICKSON. That's right.

Mr. COLLINS. Mr. Uhalde, you've talked a lot about alternatives, alternative criterion. Is it not true that each State, through their legislature, could establish their own criteria or an alternative criteria than what these 47 States now use?

Mr. UHALDE. That's correct.

Mr. COLLINS. But based on your testimony though you are saying that Washington should do it or as Mr. Richardson has said, the bench should do it?

Mr. UHALDE. No. As I said, we filed an amicus brief supporting the State of Illinois in our interpretation of the current law and regulation that supported the State in their position. Historically, it has been an eligibility issue and the States have preeminence in setting those eligibility criteria. The question that we are asked now is ought there be new legislation enacted for this issue?

And we think that before anything like that is done that there is information that this Congress does not have that it ought to have in order to make its decision.

Second, this is one court in one district, the seventh circuit, and we believe historically that our position with regard to States and the Federal/State relationship has been upheld throughout courts over many years, I mean since 1932.

We believe, on an appeal, that it's very likely that this position of Illinois could be sustained. And it would be beneficial if one went through this appeal process and got that ruling rather than reacting to this immediate one-court decision.

Mr. COLLINS. But you keep mentioning though that we should seek more information. Where are you seeking your information from? I mean I believe that's what this panel is for today.

Who are you going to for your information?

Mr. UHALDE. We're getting our information from all the 50 States and an actuarial analysis of the impact of these decisions. We have had contracts let. We work with the States in order to make these actuarial estimates of the impacts on both benefits and on costs, including costs of employers and administrative costs.

Mr. COLLINS. Well, we have 60 years of history, is that not information well enough to make a determination?

Mr. UHALDE. That is information on the status quo.

Mr. COLLINS. You said yourself that we have had several court rulings that have upheld those decisions. Why should we force Illinois and 22 or 23 other States to continue to spend money to try to seek the same decision that has been made and rendered by other courts, why?

Mr. UHALDE. Because we believe that it's important. We believe that it is also——

Mr. COLLINS. But the other decisions were not important? We are seeking another decision, even though you think that it may be the same decision? Why not go ahead and legislate this thing and send it down to the White House and let the President sign it? Would you not recommend he sign or uphold what other courts have already upheld?

Mr. UHALDE. No, we think it is premature at this time to do the legislation.

Mr. COLLINS. That wasn't the question I asked. Would you recommend the President sign, yes or no?

Mr. UHALDE. I don't make recommendations to the President on signature of legislation at this point. I would have to see the legislation; I would have to see what it's going to do. I would have to see whether it is going to address other issues in this area. This is a very piecemeal approach to an issue.

Mr. COLLINS. It would do exactly what's been rendered by the courts for the last 60 years that you have said you agreed with.

Mr. UHALDE. That's correct.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. MCCRERY. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

I wasn't planning to ask a question but Mr. Uhalde, I was struck by something you had said that I may have misunderstood, to the effect that this court decision primarily would have an impact on

Illinois. Am I misquoting you on that or is that a misunderstanding of the thrust of your remarks?

Mr. UHALDE. I believe the impact is within that circuit court district which is Illinois, Wisconsin and Indiana.

Mr. ENGLISH. OK. I was curious because looking at the amicus brief filed in this case by the administration and I'm going to quote from it, the claim was made,

Given the widespread use of the type of base period employed by Illinois an order striking down the Illinois law undoubtedly would cause nationwide disruption in the various States' unemployment compensation system.

So, you are arguing that the claim in the brief maybe was overstated? That there was not likely to be that kind of orbit of comparison?

Mr. UHALDE. I think the direct—as I understand the law—the direct legal interpretation by the circuit court applies to these three States I mentioned. I believe probably the amicus brief was then talking about the influence that that might have on other States over time.

Mr. ENGLISH. I guess my concern is—and, again, I have not seen the legislation myself—that given the legislative process here, if the existing court decision is upheld and the Supreme Court does not knock down the *Pennington* case as it has been currently decided, is this not a decision likely to be applied nationwide before Congress would have an opportunity to act in a year or two?

That, to me is a very real concern suggesting that we ought to be acting quickly if, in fact, this is potentially a major source of disruption of unemployment insurance.

Mr. UHALDE. I believe quick is relative. We don't believe that this is going to impact nationwide within the period that we're talking about. We want to get information back. We have all the analysis and reports coming in, in March of next year. So, we don't believe that this is going to spill over between now and then and if we can go to the Supreme Court, as you are suggesting, that certainly isn't going to happen between now and March or the spring of next year.

Mr. ENGLISH. Thank you very much.

I will yield back the balance of my time.

Mr. MCCRERY. Mr. Nussle.

Mr. NUSSLE. Thank you, Mr. Chairman.

I wasn't going to ask any questions either but you have me baffled. What information are you waiting for? What's coming in March that—I mean you filed an amicus brief without this information in support of Illinois and now you are telling us to wait. What was enough information for you to file a supporting amicus brief to start with but you're telling us now when it's going to affect, nationwide, possibly 49 States that we ought to wait until March to get some information. What information are you, are we going to get that is going to help us here that we don't already have?

Mr. UHALDE. The amicus brief was filed and in reading in the amicus brief the amicus brief spoke strictly to the legal question.

Mr. NUSSLE. OK, that's fine, but what information are we going to get by March?

Mr. UHALDE. The question and the information that we are going to get is on the impacts and the costs of the alternative base periods or not having alternative base periods. Which individuals are affected, what are the administrative costs, what are the benefits paid and the costs to employers of this court ruling if it went to the balance of the 47 States.

Already here, we've discussed the difference between an impact of 1½ percent in terms of benefits and the impact of 6 percent in terms of benefits. That's quite a difference and we think we need that information to then——

Mr. NUSSLE. To do what? To recommend whether or not we are going to preempt the States or not? I mean no matter what information you get back, are you going to come to us and say, Now, we want to make this Federal if it is six or if it's five or if it's one? Are you going to come to us at any of those ranges and recommend that we take over this system and preempt the States and not let them determine the base period?

Mr. UHALDE. No. We don't believe that we have——

Mr. NUSSLE. Well, then what information are we waiting for that is going to impact this decision, that's what I don't understand.

Mr. UHALDE. I do not believe and we do not believe that the Congress wants to make a decision without knowing the implications as to costs.

Mr. NUSSLE. You made the decision to support with an amicus brief without this information. Now, you're telling us to wait. It was OK for you to do it?

Mr. UHALDE. It was a decision in terms of our interpretation of the law and regulation.

Mr. NUSSLE. And we are interpreting the court decision and the information we have. We have our bevy of attorneys and staff looking into it. We have the opportunity to listen to the experts who are here today from Illinois and West Virginia and elsewhere. They're telling us it is probably a good idea to get involved in this.

And why are your experts more interesting or more accurate than our experts or why is it that there's information—I mean, what information are we going to get? You have not convinced me that there is any information out there that we're going to get between now and March that is going to either affect your recommendation to us on legislation or on our decision to pass or write legislation.

What is there out there?

Mr. UHALDE. I've stated what we believe is the importance of the information. It is not compelling to you but it's information that we think is important and ought to be considered.

Mr. NUSSLE. Well, I mean you're giving us a pretty strong recommendation here to wait. I would like you to be a little bit more compelling than I don't know what it will be or I don't know what impact it will have. I mean you're telling the States to wait and you're telling us to wait and you're telling them basically go ahead and file another appeal.

Can I ask, who pays for these appeals?

Ms. DIDRICKSON. The State of Illinois.

Mr. NUSSLE. And where does this money come from?

Ms. DIDRICKSON. Obviously from our employers. It comes back through administrative——

Mr. NUSSLE. So, you are asking small business people to put more money into the system to pay for more appeals because you want to wait for information you can't tell us about that you don't know whether it's going to be compelling? I mean this is a pretty serious—I mean that's why I wasn't even going to get involved in this. I was coming to see—Charlton Heston's going to be here. [Laughter.]

And I thought that was going to be interesting. I wasn't even going to get involved but this has got me a little bit baffled that you would tell us to wait when, you know——

Mr. RANGEL. Would my dear friend yield?

Mr. NUSSLE. No. I would like to hear from the administration what do they want us to wait for?

Mr. RANGEL. He's exhausted his answer.

Mr. NUSSLE. Well, I don't think you've got the answer, Charlie. You tell us that we ought to wait until maybe the Democrats take control which could take a long time.

Mr. RANGEL. You'll never know now, will you?

Mr. NUSSLE. Do you have any more information you can help us with as to why we ought to wait other than it may be a percentage that comes out that is not going to affect your recommendation?

Mr. UHALDE. No. I have presented to you, I believe, the reasons why we think it would be inappropriate to act now.

Mr. NUSSLE. OK.

Mr. UHALDE. Thank you.

Mr. MCCRERY. Mr. Rangel, would you like to——

Mr. RANGEL. Thank you, Mr. Chairman.

Mr. Nussle, as I see it, if we got away from the present law and the court decisions, it seems as though the court decision is more sensitive to the benefits as relates to the worker and that present law is more conservative as relates to protecting the employer.

As I understood the Secretary of Labor, he was saying that he thought it would be a cost estimate involved in this. And knowing your concern, as well as your colleagues, our colleagues' concern about cost, it would seem to me that we would not want to look at this and saying the poor employers will have to pay more money in order to exhaust our legal remedies, or that the unemployed wretched souls are getting too much.

If it's a question of degree—and nobody is against anybody, employers who create the jobs or employees who do the labor—it's just how much do you think is a fair amount and how much does it cost the State of Illinois or the employers throughout the country?

And, would that, Mr. Secretary, be one of the things that you could bring to this Subcommittee?

Mr. UHALDE. That is precisely the information that we feel is important for the Subcommittee to have—the costs to employers, both the continuing benefit costs and the administration costs and the benefits that accrue for an alternative base period to claimants. And that's information that we just think is relevant to this.

Mr. RANGEL. Now, we don't have any objection, Madam Comptroller, that the courts would be creating the law and the voice of the people will not be heard. I know you adopted that from one of

the Members. But you don't truly believe that the voice of the people will be denied as a result of us waiting, do you?

Mr. UHALDE. No.

Ms. DIDRICKSON. I guess, Congressman, my question is, what is the benefit of waiting? And I believe that the real question here is a preemption question, did Congress, 60 years ago, intend to preempt States rights?

Mr. RANGEL. Well, let me ask you this.

Because I don't presume that you know whether the voice of the people are the unemployed workers or whether the voice of the people are the more politically powerful employers but isn't the issue really whether an employee receives more or less benefits?

Ms. DIDRICKSON. No. The issue really is whether or not 60 years ago did Congress intend to preempt States rights? Should we have the ability, as a State, to be able to establish our base period? That is the issue.

Mr. RANGEL. And if the voice of the people had an opportunity to be expressed, you think they would think that is the issue?

Ms. DIDRICKSON. The voice of the people do have a voice in the State of Illinois through their legislative body——

Mr. RANGEL. But we are talking about——

Ms. DIDRICKSON [continuing]. When we established the base period.

Mr. RANGEL. But notwithstanding the sovereign rights of the State of Illinois, there is a Federal role here, don't you agree, please, yes?

Ms. DIDRICKSON. I believe that there is a Federal role here in terms of the legislative body here to determine whether or not did Congress intend to preempt States rights 60 years ago.

Mr. RANGEL. And I know you would not deny us the opportunity to have as much information in front of us as possible to make certain that we get it right.

Ms. DIDRICKSON. Well, I think you've heard from your colleagues on this panel how much information and what information and 60 years' worth of precedents with regards to allowing States to be able to establish their own base period and the fact that 49 States have a similar situation with Illinois and that there is a nationwide implication here that is very, very immediate and very clear.

Mr. RANGEL. Your response shatters the reason for panels. If I have to listen to my colleagues, in the Majority, then I'm out of business.

Ms. DIDRICKSON. But you could also then listen to it. It also shatters it if we are going to let the bench legislate versus you, Congressman.

Mr. RANGEL. Well, the court made a decision and under our legal system you appeal it and after you exhaust your legal remedies then that would be the time for us to act. Unless there is an emergency and the Congress believes that we have to make certain that the voice of the people, as heard through the employers, is protected, then let's move swiftly.

But if we want to find out whether or not the decision is too generous for the employers in the States, then I think that I would want as much information as possible.

Mr. Secretary, can we accelerate whatever information is available and let your people know that this is a very urgent issue, that the whole Nation is waiting to see how we're going to handle this case that comes out of Illinois? Could we do this because we are floundering for something besides cigarettes to deal with. Can you find out how quickly can we get that information? Can we get it so we can get a bill out of here before we adjourn?

Mr. UHALDE. Absolutely, Mr. Rangel. We will see how quickly we can get that information.

Mr. RANGEL. OK. I assume when I get home at the townhall meetings they are going to be asking, What the heck have you done with that case in Illinois and I want to be able to say we are responding because we want the voice of the people in this Congress to be heard. I can't wait to get the information.

Thank you.

[The following was subsequently received:]

STUDY

Analysis of Unemployment Insurance (UI) Claims - Revised Base Period in the UI Program

VENDORS

Planmatics Inc. (Primary)
Urban Institute (Sub)

PURPOSE

The purpose of this study is to examine the implications of states providing Alternative Base Period (ABP) options to UI claimants. This study will provide information which will assist national and state level policy analysts in decision making with regard to the implementation of ABP.

In its Request for Proposals process, the Department of Labor outlined twenty three research tasks. Cost concerns limited this study to twelve of those tasks. These tasks can be grouped into three major areas of study. They are:

(A) Effects on UI Trust Funds

(B) Effects on UI Administrative Costs

(C) Effects on Employers

DELIVERABLES

	DELIVERABLE	DELIVERABLE DATE
1.	Preliminary report on the Trust Fund Model based on one state.	January 1996
2.	Preliminary report on the Administrative Cost Process Model	May 1996
3.	Completed Trust Fund Model based on eight states.	July 1996
4.	Preliminary report on Employer Costs	October 1996
5.	Draft final report on the entire project	May 1997
6.	Final Report	June 1997

Mr. MCCRERY. I thank the gentleman for attempting to clarify the issue.

I thank the members of the panel for your testimony. It has been very helpful. I think the issue to most of us is quite clear. We do look forward to trying to clarify this issue for the States. Thank you.

Mr. UHALDE. Thank you.

Ms. DIDRICKSON. Thank you.

Mr. CAMP [presiding]. If we could have the next panel come forward please. Hon. David Poythress, Warren Blue, Walter Curt.

Good morning and welcome to our witnesses. This panel is on the devolution of unemployment insurance and we will begin with Hon. David B. Poythress, Georgia Commissioner of Labor.

Let me just say that your full written comments will be placed in the record and we are asking that witnesses confine their remarks to 5 minutes. A small red light will go on to let you know when your time has expired and, at that point in time, if you could wrap things up we would appreciate it.

Thank you.

STATEMENT OF HON. DAVID B. POYTHRESS, GEORGIA COMMISSIONER OF LABOR

Mr. POYTHRESS. Thank you, Mr. Chairman.

I appreciate the opportunity to be here extended by the Chairman and my fellow Georgian, Mr. Collins.

I'm the State Labor Commissioner of Georgia. Before talking about devolution I would like to add one observation on the *Pennington* case that was made quite astutely by Ms. Didrickson and I think it is worth bearing in mind. *Pennington*, pressed to its logical conclusion, stands for the proposition that a State unemployment insurance agency would have to do whatever it takes to pay the maximum amount of money to any given claimant.

That case imposes on a government insurance program an organizing principle which is essentially welfare. And I think that is, not only is *Pennington* a bad decision, it is bad for a profoundly important reason and we wholeheartedly support the Illinois legislation. We would recommend that it be passed as soon as possible.

On the subject of devolution, Mr. Chairman, I have submitted my written report. I would like to speak informally a little bit about the history of that concept and then to describe the existing unemployment insurance system and then how I have proposed that it be changed for the better.

First, I would say that this concept has been around for a long time. It has been discussed in labor circles for at least a decade. From a technical standpoint most all of the issues have been hashed over, and it has been very thoroughly thought out from a technical standpoint.

The concept that I have proposed is based on some pioneering work that was done in New Hampshire. Colleagues in other States, most notably in Virginia, concur with it. I believe it provides a wonderful opportunity to genuinely return power to the States, to lay the groundwork for major tax cuts and for minimizing some of the Federal regulations that States have to put up with. It's an op-

portunity to minimize paperwork on the American business community.

The present employment security system is funded by two taxes. The first is the State benefit tax. That money is collected locally by State departments of labor. It is deposited in State-specific trust accounts which are managed by the Treasury Department. That money is expended only for benefits, unemployment insurance benefits. Within general operating guidelines, States have essentially unrestricted access to their own benefit moneys.

The other payroll tax is the FUTA tax or the Federal Unemployment Tax Act tax. Those funds are collected to pay for the administration of the system.

They are collected by the Internal Revenue Service. They are also computed against salaries. They are collected quarterly. The Internal Revenue Service transmits that money to the U.S. Department of Labor and the U.S. Department of Labor expends it in various ways.

Our best information is that the cost of collecting that tax by the IRS is about $75 to $85 million a year. Our friends in the small business organizations have estimated that as much as a half a billion dollars is expended by American businessmen, businesspeople in maintaining the separate tax system. Paying two taxes, two checks, two forms, two audits, two everything.

When the money is received in the U.S. Department of Labor it basically goes to four different spending categories. The first is subsidies to small States which do not have an employer base big enough to generate enough tax to pay overhead. That does not necessarily represent any sort of inefficiency on the part of those States. They are simply small States. That's a fact of life and the proposal that I have made would hold those States harmless.

The second amount of money goes to pay actually the operating costs of the U.S. Department of Labor, that's about 5 percent, and we think that's about right.

And about 60 percent of the money is returned to the States for administration. The problem is it is not returned dollar for dollar. In some States, they get materially less than what their employers pay in. In Georgia, we get about 40 cents on every dollar that our employers pay. Therein is the nut of this problem.

The fourth avenue through which those funds are channeled is into a series of trusts which are maintained by the U.S. Department of the Treasury and the money, in effect, cascades through three sets of trusts. The first is called the administrative account or the administrative trust. The second is the extended benefits account. And the third is a loan account for loans to States whose benefit accounts go insolvent.

The proposal that I have made is that the two taxes be combined. Not legally. They would be maintained as separate legal taxes. But they would be combined and collected by the States. There would be a single tax form, a single check, and a single audit. The moneys would be deposited in State-specific benefit accounts, as they are now, but also State-specific administrative accounts, also maintained by the Treasury for security purposes. And the States would have, within broad guidelines, unrestricted access to their own administrative money.

From those administrative collections, a percentage amount as determined by the Congress through the budget process would be redirected to the U.S. Department of Labor to fund their operating costs. In Georgia, as I mentioned, we get back about 40 cents on the dollar. If we were able to keep 95 percent on the dollar, we would be postured to extend to our employer community enormous tax cuts almost immediately. Also, we see the implementation of this as taking no more than 12 months and not a lot of money.

The final point of the recommendation has to do with the disposition of the trusts. This is the most technically and the most legally and politically complex part of the whole proposal. We have recommended that the administrative trust be abolished and that those funds be redistributed to the States on a pro rata basis, that is, on the basis of covered wages, to be used initially to fund the cost of the conversion. There would be some data processing costs involved.

And we have recommended that the extended benefits account trust also be eliminated and those moneys redistributed to the States into their benefit accounts on the same basis of covered wages. The Extended Benefits Program is used very little by only a few States and we feel like it has very little real utility as far as a national public program is concerned.

And then, finally, we have recommended that the loan account be maintained but that it be capped at a certain amount as determined by the Congress, so that funds do not continue to build and build and build.

As I said at the outset, Mr. Chairman, this is a wonderful opportunity to really return power to the States, to minimize the paperwork burden on American business and to posture the States to grant major tax cuts to their employers.

Thank you.

[The prepared statement and attachments follow:]

Statement

By

David B. Poythress

Georgia Commissioner of Labor

To The

House Committee on Ways and Means

Subcommittee on Human Resources

July 11, 1996

Mr. Chairman and Members of the Subcommittee, my name is David Poythress, and I am Commissioner of Labor in Georgia.

I appreciate the invitation to appear today and present my views on both the federal court's ruling in the Pennington Case and my proposal to transfer the Administration and Financing of the Employment Security System to the States.

Position on the Pennington Case

With the unique Federal-State partnership created by The Social Security Act of 1935, states have retained broad discretion to design their own unemployment insurance programs including allowable benefits, amount of earnings necessary to qualify for benefits, and all other eligibility requirements within broad fairness guidelines.

The 1994 decision by the Seventh Circuit Court of Appeals ruled that the base period process used by the Illinois Unemployment Insurance Act is an "Administrative Provision" subject to the "when due" clause of the Social Security Act. This ruling is plainly contrary to the universal understanding, throughout the 60 year history of the Unemployment Insurance program that "base period" determination is an eligibility requirement within the ambit of state authority. The base period concept is not a matter of administrative convenience. It represents the public policy judgment of states that UI benefits should be payable only to persons with a demonstrated continued attachment to the workforce.

The Social Security Act of 1935 clearly envisions broad latitude by states in designing their unemployment insurance programs. I urge you to enact legislation making congressional intent clear that states are responsible for determining the terms and conditions under which unemployment benefits are paid including the establishment of base periods.

Transfer of Administration and Financing of the Employment Security System to the States

The Employment Security System is composed of two major components. The Unemployment Insurance system (UI), created by the Social Security Act of 1935, is designed to provide workers with insurance against involuntary unemployment by partial replacement of lost wages. The Employment Service (ES), established by the Wagner-Peyser Act of 1933, is designed to provide job search assistance to individuals and recruitment and referral services to employers to get workers back to work as quickly as possible.

The UI and ES programs are highly integrated, and each depends on the other for efficient administration, success in serving job seekers and employers and keeping employer payroll taxes as low as possible.

Currently each state sets and collects a state payroll tax for UI benefits and deposits those funds into state-specific Benefit Accounts maintained by the federal government as part of the Unemployment Trust Fund (UTF). A separate federal payroll tax, collected by the Internal Revenue Service (IRS) under the Federal Unemployment Tax Act (FUTA) is a dedicated employer tax to support administration of the Unemployment Insurance (UI) laws and the Employment Service (ES). FUTA was established as a contract with private sector business that these dedicated taxes would be used only for unemployment and employment services.

The concept of "devolution" of most of the management of the Employment Security System from the U. S. Department of Labor to the states has been studied carefully for many years in labor department circles. It is fiscally sound, administratively simple and politically realistic. I believe the time to implement it is now.

I have attached, for the record, a copy of the Executive Summary of Georgia's Proposal to transfer the administration and financing of the Employment Security System to the states.

This very straightforward proposal does three main things.

1) It establishes a single, state-collected payroll tax for both UI benefits and UI/ES administration,

   --Eliminating the current duplicative tax system and saving private sector employers approximately half a billion dollars annually in filing costs;

   --Eliminating IRS collection of the federal payroll tax, thus saving $75 to $80 million each year;

   --Making the marginal additional cost to the states to collect "both" taxes negligible.

These savings could begin as soon as states - instead of the IRS - begin collecting the .8% FUTA tax. At the point when a state adopts its own administrative tax, the .8% federal FUTA tax would be completely offset to the employer. State collections would be deposited in state specific accounts in the UTF to avoid any adverse impact on the federal deficit.

2) It eliminates micro-management of state programs by the U. S. Department of Labor (USDOL) and establishes the foundation to downsize the USDOL bureaucracy by 50% to 75%.

3) It assures that the employers who pay FUTA taxes get the full benefit of those taxes. Reduction of IRS and USDOL roles will greatly reduce the costs and improve the efficiencies of the system.

In summary, Mr. Chairman, this is a wonderful opportunity to:

--Truly return power to the states;
--Lighten the paperwork burden on American business;
--Save millions in wasted tax dollars and
--Lay the foundation for future tax cuts.

I strongly encourage the committee's favorable consideration of this proposal.

A Proposal to Transfer the Administration and Financing of the Employment Security System to the States

Executive Summary

By

David B. Poythress, Commissioner
Georgia Department of Labor

The Employment Security System is composed of two major components. First, the Unemployment Insurance system (UI), created by the Social Security Act of 1935, is designed to provide workers with insurance against involuntary unemployment by partial replacement of lost wages. Secondly, the Employment Service (ES), established by the Wagner-Peyser Act of 1933, is designed to provide job search assistance to individuals and recruitment and referral services to employers, to get workers back to work as quickly as possible.

The UI and ES programs are highly integrated and each depends on the other for efficient administration; success in serving individuals and employers; and, keeping employer unemployment taxes as low as possible.

Currently each state sets and collects a state payroll tax for UI Benefits and deposits those funds into state specific Benefits Accounts maintained by the Federal Government as part of the Unemployment Trust Fund (UTF). A separate federal payroll tax, collected by the Internal Revenue Service (IRS) under the Federal Unemployment Tax Act (FUTA), is collected as a dedicated employer tax to support administration of the Unemployment Insurance (UI) laws and the Employment Service (ES). FUTA was established as a contract with business that these dedicated taxes would be used only for unemployment and employment services.

The concept of transferring the Administration and Financing of the Employment Security System to the States, usually referred to as "Devolution", has been studied for many years and is fiscally sound, administratively simple, and politically realistic. It also would be easily compatible with any of the several Employment and Training block grant proposals currently before Congress.

Our relatively simple devolution proposal would accomplish several objectives:

- *Establish a single, state-collected payroll tax for both UI benefits and UI/ES administration;*
- *Eliminate the current duplicative tax system saving American businesses approximately half a billion dollars annually in paperwork and filing costs;*
- *Eliminate IRS collection of the FUTA taxes, thus saving $75 to $80 million each year;*
- *Significantly reduce micro management by the USDOL and establish the foundation to downsize the USDOL by up to 75%;*
- *Assure that employers get the full benefits of the FUTA taxes they pay by reducing the roles of IRS and USDOL;*
- *Return power to the states and lay the foundation for possible tax cuts.*

Our guiding principles, applied in Georgia's proposal for a devolved employment security system, are these:

* *The primary Federal role should be to assure that state laws and policies conform to requirements to maintain a public employment service and an unemployment insurance program as prescribed in federal law;*

* *Authorize states to collect a single payroll tax including administrative and benefits components, to be maintained in separate state-specific Trust Accounts managed by the Treasury Department;*

* *Treasury Department would continue to manage all unemployment Trust Fund accounts so that funds will continue to be counted in deficit calculations;*

* *Develop clear, strict solvency standards for state administrative trust accounts structured similar to current state unemployment benefit trust accounts;*

* *Allow a 100% offset of FUTA taxes to employers (currently .8% of wages) at the point a state adopts its own administrative tax;*

* *Maintain a hold harmless funding level for states who would lose grant funds with devolution;*

* *Provide financing of national activities from state Administrative Accounts; but only for essential federal oversight requirements and state "hold harmless" supplements. We anticipate this would not exceed 5% of total administrative taxes collected;*

* *Assure states full access to state administrative Trust Accounts within solvency standards established. This would mirror current handling of State Benefits Trust Accounts;*

* *Relinquish all federal claims on equipment and property purchased with FUTA funds upon approval of each state's plan to assume responsibility for administration and financing of the Employment Security System.*

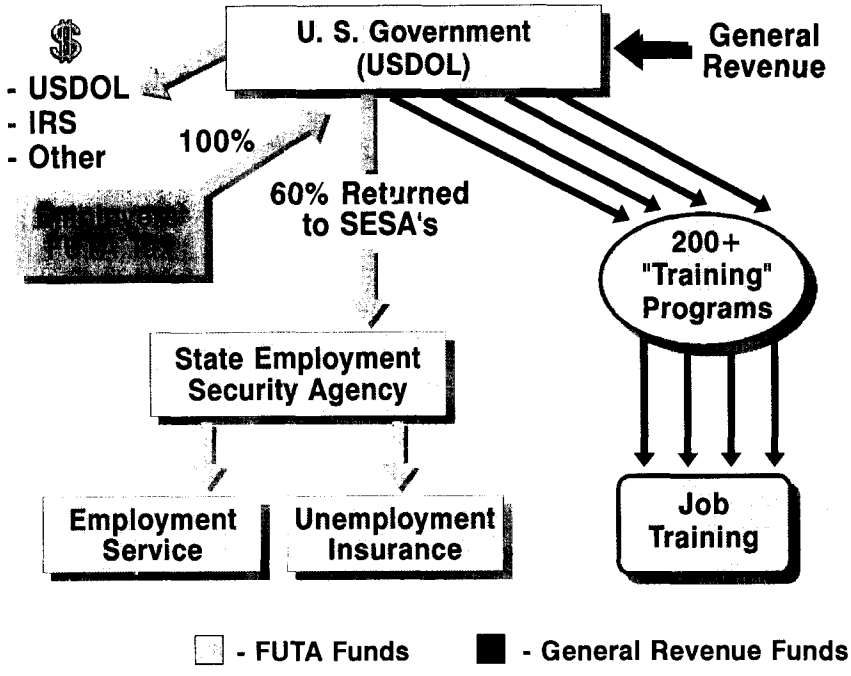
I am attaching several diagrams showing the present and proposed employment security systems at a conceptual level. The differences in the several state devolution proposals are primarily form rather than substance and can be readily reconciled in the legislative process.

This is a <u>wonderful</u> opportunity to:

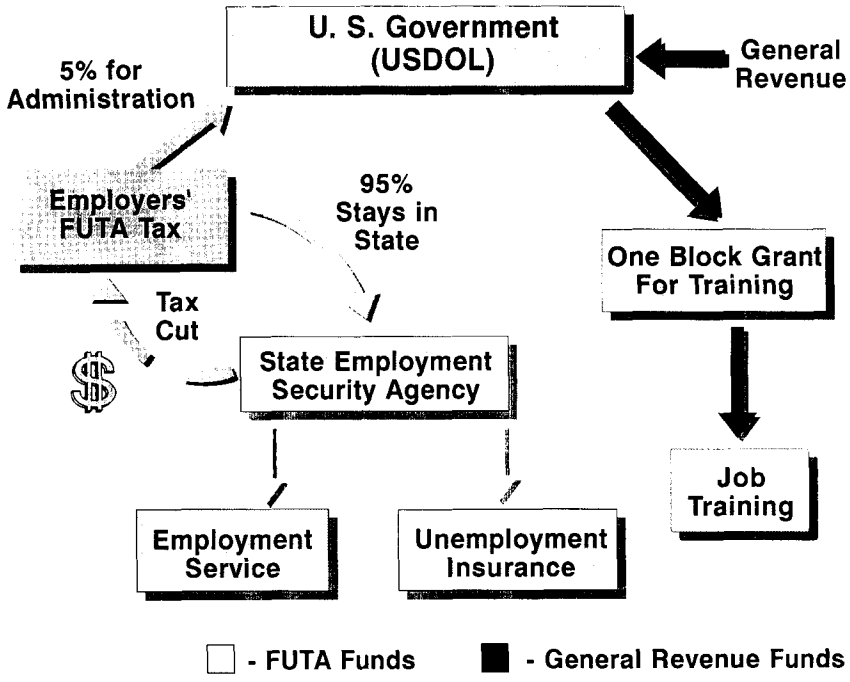
--<u>Truly</u> return power to the states;
--<u>Lighten</u> the paperwork burden on American business;
--<u>Save</u> millions in wasted tax dollars; and
--Lay the foundation for <u>future tax cuts</u>.

I strongly encourage your review and support of this proposal.

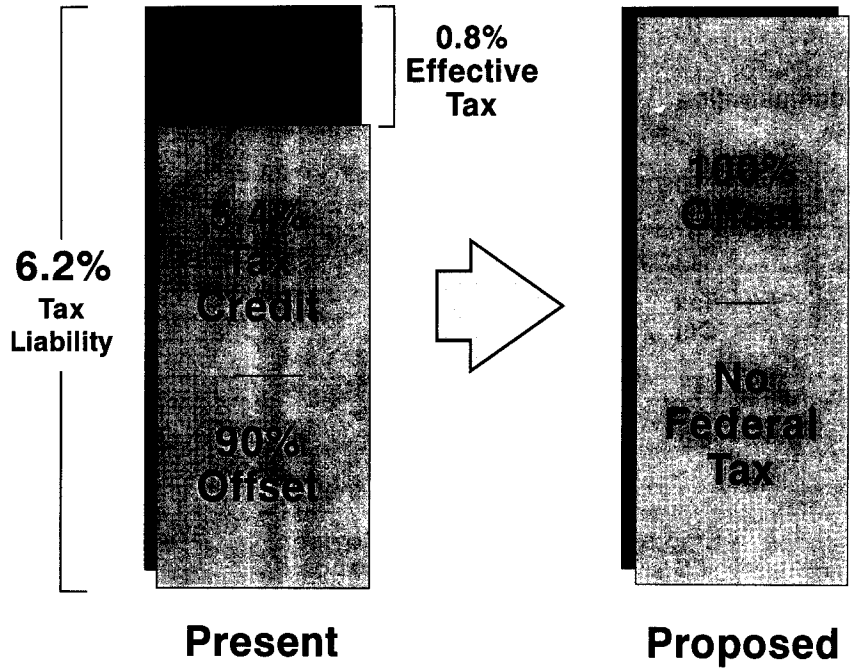
Employment Security and Training Financing Present



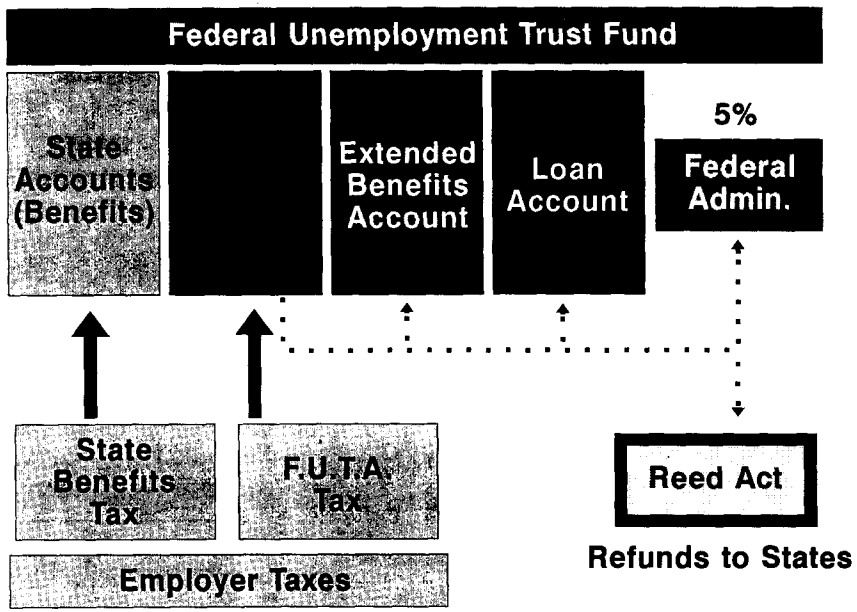
Employment Security and Training Financing Proposed



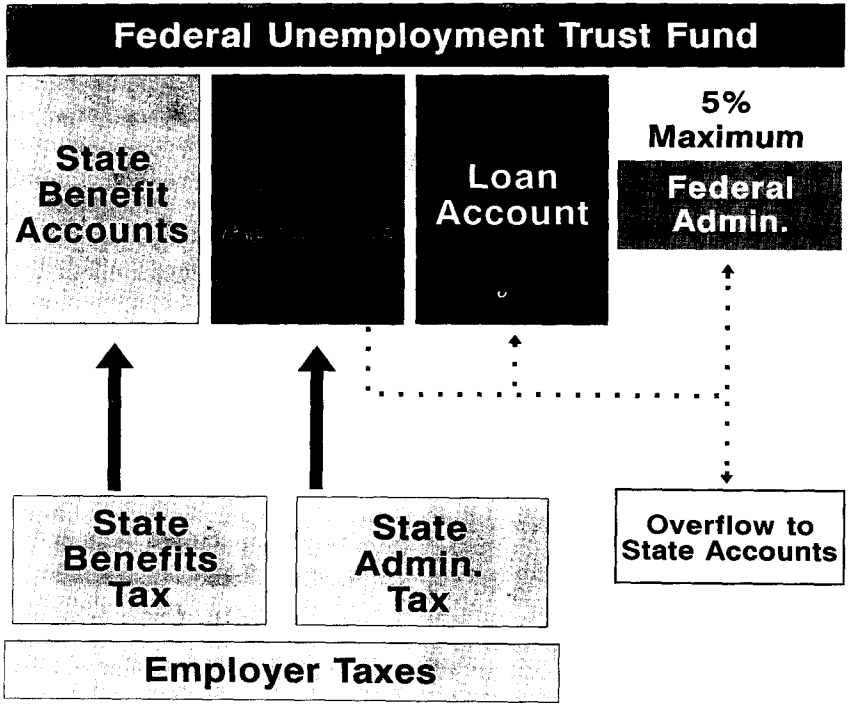
Employment Security System
Administrative Financing



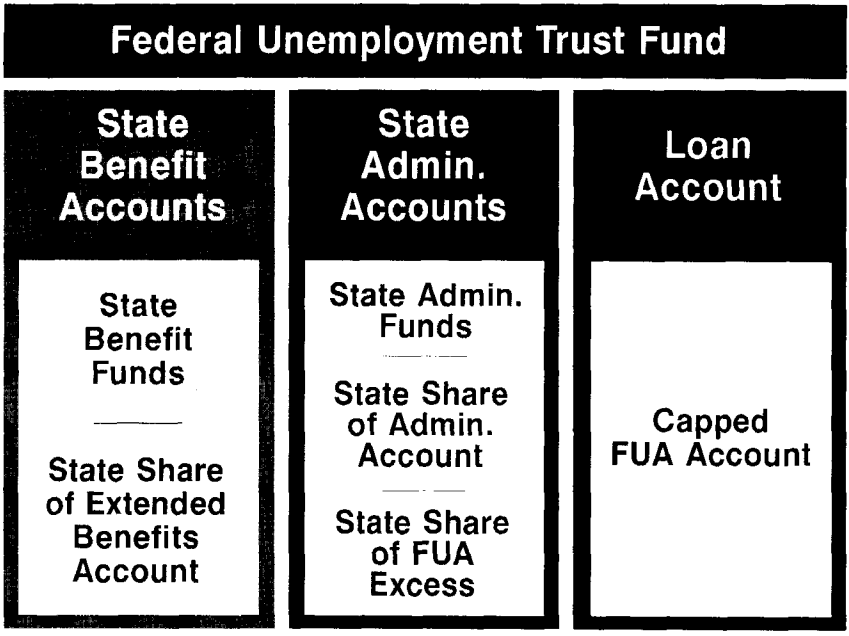
Employment Security System Financing
Present



Employment Security System Financing Proposed



Employment Security System Financing Proposed



Mr. CAMP. Thank you very much.

And now, Warren Blue, senior vice president and general counsel of R.E. Harrington, Inc.

STATEMENT OF WARREN G. BLUE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, R.E. HARRINGTON, INC., COLUMBUS, OHIO; AND CHAIRMAN, NATIONAL COALITION FOR UNEMPLOYMENT COMPENSATION TAX REFORM

Mr. BLUE. Thank you, Mr. Chairman.

I'm appearing here today as the chairman of the National Coalition for Unemployment Compensation Tax Reform.

This is an organization consisting of employer associations and hundreds of individual employers who have concerns with the very point that Mr. Poythress was making as to the efficiency of the use of the Federal taxes collected from employers.

Some of the organizations that are part of the coalition include the National Association of Manufacturers, NFIB, U.S. Chamber of Commerce, the American Payroll Association, and the UBA, Inc., of which Charles Little, who is president of UBA is here with me, and I'm on the board of UBA, Inc.

There are two major problems that have brought employers to this position of having formed this coalition. The first one has been an ongoing problem since the middle or late eighties and that is the continual taxing of employers with a two-tenths percent surtax which was imposed in 1976 to pay off a debt that the Congress incurred when they extended the Unemployment Benefit Program, borrowed general revenue funds and then told employers they were going to have to pay the money back. That debt was paid off in 1987. It has since been extended four times and most recently extended to the first part of January, January 1, 1999.

To make matters worse, the administration has proposed extending this two-tenths to 2006, and after 2002, require employers to report and pay this tax monthly, rather than quarterly.

We see no need for the extension of this tax. We are in favor of a repeal of this tax and we obviously oppose the administration's concept of continuing taxing to reduce the deficit, because that's what the money is used for. This costs about $1.5 billion a year to the employers of this country.

Our second major problem consists of the system which now basically is taxing the employer community twice to pay for the administration of the program throughout the United States. Congress has seen fit to only appropriate 60 percent of the money that the employers are paying in the FUTA tax to be used for administration in some of these other trust funds that Mr. Poythress has just mentioned.

And to make matters worse, some 21 States have decided since they are not getting enough money back—remember Congress is only giving 60 percent of the money back—that they have come up with separate taxes, including the State of Georgia, to pay for the administration since they need the funds in order to provide the program to claimants and employers.

All States, except five and the Virgin Islands, receive less than collected from the tax the employers pay. Indiana only receives 37

percent back of the moneys that the employers in that State are paying.

This shortfall is a disservice, Mr. Rangel, to claimants and to employers, and we believe something should be done and we believe that devolution offers an opportunity to correct this problem.

Let me give you some ideas of what this service is. Federal law requires that benefits be paid through the public employment offices. Most States have cut those back. Some of them have almost done away with them because of the lack of funds. It is intended that the UC claimants are exposed to job search assistance at these offices and many of these offices just don't exist any more in some States. Ohio has cut back by over 40 or 50 percent.

Federal law also requires the public employment service to administer the work test to UC claimants and this is intended to identify claimants who are not making conscientious efforts required by the State law to find new work and, thus, should not be receiving benefits. Identifying these claimants properly, having the funds to identify these claimants properly is vital to maintaining the integrity of the system. And studies have shown that money being placed in job placement services is an effective use of scarce resources.

Included among the advantages of devolution, we believe, are many of the comments that Mr. Poythress just made, more resources at lower cost, increased compliance by employers due to State enforcement. There are a lot of employers out there not paying the tax and it's only going to be really enforced if the States can get at that. The Federal Government cannot get at that.

Reduce administrative costs, we believe will get fewer forms. IRS won't be involved any more, that costs money. The State agencies will have more flexibility and with fewer mandates and probably have more money at lower costs to employers.

Now, we do believe that you need to address the Federal Extended Benefits Program because this is important in crafting the legislation. And the wage base differential, a need for borrowing by States when they do run out of funds, and perhaps in situations where there is a temporary shortfall of funds.

We are not advocating eliminating the DOL function in compliance issues. We are not advocating eliminating some of the Federal compliance requirements. We are advocating a more efficient and flexible use of the funds.

Let me finish up—and I almost hesitate to bring this up—on the *Pennington* case. The Advisory Council was mentioned as getting into alternative base periods. If you read that report, the Advisory Council said, it's a States rights issue. It suggests that States look at alternative base periods, but it does not suggest a mandate by either the court system or by Congress to do that.

We have done a little survey and the employer community is estimating the cost to research the information, the wage information that is needed to comply with this other base period that has been added on could run between $15 and $20 per claim. And we wonder what a cost benefit analysis would really produce.

Now, I understand the Department of Labor claims that they need one. I don't think it's necessary, it just ought to be done and done now. California and New York have already proposed legisla-

tion for alternative base periods. And it is our opinion that they are being proposed only because they think the court system has already told them to do so. Those are big States. California is a $75 million administrative cost item for just to put the program in place.

So, it's got to be done and it's got to be done now. We look forward to working with you on all these issues.

Thank you.

[The prepared statement and attachments follow:]

Statement of Warren G. Blue to the House Ways and Means Subcommittee on Human Resources

Re: Unemployment Compensation Reform

July 11, 1996

I am Warren G. Blue and appear here today as Chairman of a Coalition of business organizations, including UBA, Inc. and the American Payroll Association, and businesses concerned with Unemployment Compensation issues. A list of the members of this Coalition for U. C. Tax Reform are appended to my statement. I am Senior Vice President and General Counsel of R. E. Harrington, Inc., Columbus, Ohio, a nationwide Unemployment Compensation Third Party Administration firm representing many thousands of employers in all states.

Before we discuss solutions, it seems appropriate to identify the existing problem for employers regarding the collection and use of FUTA tax revenue.

1. Present Federal revenue collected from employers to pay for the administration of the state unemployment compensation program, as well as to reserve some money for specific funding of possible loans to states and to pay the federal share of the extended benefit program, is almost $5.6 billion per year. Department of Labor figures for fiscal year 1994 indicate that the states received back in grants only 60.1% of the revenue paid by employers in FUTA taxes. In that year, total FUTA taxes amounted to $5,538,600,000 while grants were only $3,327,800,000. The amount returned to states range from a low of 37.5% for Indiana to a high of 268.5% for Alaska. Only six states received more in grants than they paid in FUTA taxes. All the overages for these six states could have been paid by the short-fall of a single state - Florida, for example.

We believe that the refusal by Congress to appropriate tax revenue to the states for the purpose collected has resulted in claimants being under served as it undermines the efforts of the state Employment Agency to match available jobs to appropriate claimants, and has consequently increased the duration of the payment of benefits. The effect is obviously also detrimental to employer interests because the result is not only increased costs but also unfilled jobs.

2. As a result of this shortfall of revenue to the states to administer programs, fourteen states have enacted separate taxes on employers to pay for needed administration costs and thus employers are paying the tax twice. The states with specific administrative surtaxes are Alabama, California, Colorado, Delaware, Georgia, Idaho, Iowa, Louisiana, Maryland, Montana, Nevada, New Hampshire, South Carolina and Wisconsin. In addition, seven other states (Hawaii, Minnesota, Oregon, Rhode Island, South Dakota, Texas and Washington) have surtaxes to support what is referred to, variously, as job or economic development, training, work search or aid to dislocated workers, which in reality are administrative surtaxes by another name.

3. The present system is inefficient and costly as it requires employers to complete both federal and state forms, pay a collection fee to the Internal Revenue Service, has cumbersome rules for state agencies to comply with federal mandates, created large separate federal funds with significant reserves which may not be necessary and perpetuates a "temporary" 0.2% surtax on employers which is not necessary and should have been terminated as the law originally provided in 1987. Attached is a chart showing the history of this tax.

In regard to the separate funds it should be pointed out that FUTA funds are deposited in the following Federal Accounts: Administration Account (ESAA), Loan Account (FUA) and the Extended Benefit Accounts (EUCA). The projections contained in the President's FY 1997 Budget show the balance in these three accounts increasing from $15.8 billion in 1996 to $26.8 billion in 2001.

These projections assume that the 0.2% surtax will finally be permitted to terminate at the end of 1998 as provided in current law.

Employers have reason to be skeptical that the 0.2% FUTA surtax will actually be permitted to expire at the end of 1998. This tax was first enacted in 1976 to repay a $6.2 billion Extended Benefit (EUCA) debt. The tax was supposed to be paid for five years. In 1982 it was extended until the debt is repaid. The debt was repaid in 1987, but the tax has been extended four times since then and in 1994 the Clinton Administration proposed to make it permanent to fund their proposed Reemployment Training program. The Administration has proposed extending the 0.2% FUTA surcharge to 2007, and requiring depositing state and FUTA taxes monthly starting 2002 for employers of 20 or more.

A possible solution to many of these problems just discussed could be accomplished by the adoption of the concept of devolution of the FUTA tax to the states while still maintaining some federal control of the system.

The most common means suggested for "devolving" power from the Federal government to the states has been the use of block grants without the strings and detailed Federal requirements of categorical grants. However, in the case of the Federal-State Employment Security Program the most logical and best approach may be by use of a "100% Offset". The Offset would increase the current 90% credit to 100% of the 6.0% Federal Unemployment (FUTA) tax rate which is applied against unemployment taxes of states complying with Federal requirements.

Use of a 100% Offset would reduce the FUTA tax rate to zero and relieve employers of the burden of filing returns and depositing the tax with the IRS. It would save some $94.9 million the IRS projects as their cost of collecting the tax in 1996, and millions used by the Department of Labor to determine state allocations, conduct audits, etc.. A prior 1985 devolution proposal by the then OMB Assistant Director, John Cogan suggested simply reducing the effective net Federal tax, rather than 100% Offset, in order to fund those Federal Employment Security activities that would continue. However, from an employer viewpoint, not providing a 100% Offset would eliminate an important advantage of devolution - that is doing away with the filing of returns and depositing funds with the IRS.

There are a number of benefits from devolution that could be realized by all parties concerned - the states, employers, claimants and the Federal government:

1. The states would be given the resources to operate more efficient employment security services that meet the needs of workers and business and the employers' taxes would be used for the purposes for which they were intended.

2. Tax collections will improve and compliance burdens on employers would be lessened.

Employers will no longer have to make reports and pay two separate taxes to two layers of government - federal and state. States will collect more taxes as a result of this consolidation since this is the primary tax for State Employment Security Agencies. The states' expertise on this particular tax is much greater than the IRS which is focused primarily on other taxes. In fact the IRS relies heavily on the state agencies for audits and employer information. Also compliance will be simplified because the differences in definitions and coverage that exist between FUTA and state law will be eliminated.

3. States would be relieved of burdensome Federal regulations and requirements that hinder them in providing efficient services to employees and employers.

Federal controls have increased over the years and new Federal programs administered by the states have been added. Separate funding sources have mandated unnecessary expenditures and hindered efficiencies that might otherwise been realized. Federal savings also would result from the need for less Department of Labor program staff.

The Department of Labor would still be responsible for: (1) oversight of compliance and conformity, (2) administration of federal programs through contracts with states, and (3) federal budget and reporting requirements.

Some devolution proposals which have been suggested would make the application of the "work test" optional with the states. This is a Federal requirement, contained in the Wagner-Peyser Act, which should not only be continued, but strengthened. The "work test" is applied when the Employment Service refers an unemployment compensation claimant to suitable work. A basic requirement of all state UI laws is that for a person to draw UI benefits he or she must be able and available for suitable work. Any devolution legislation should contain specific provision to assure the close integration of the State Unemployment Insurance Services and the State Employment Services. Some states have not always done a very good job of integrating the two services and the application of the "work test" has not been as effective as it should have been. While dealing with welfare recipients and first time job seekers is an important service, the needs of the insured claimants should still be given first priority.

Employer Concerns

As we have explained, business in principle is supportive of devolution. However, we have some concerns about how specific areas would be implemented such as:

* What happens to the State Extended Benefit Programs which are financed on a 50/50 Federal-State basis with the Federal 50% coming from FUTA funds?

* Since many states have higher tax bases than the FUTA base of $7,000 will some states collect more in taxes from some employers than under the present system? And would these additional funds be needed?

* What happens to states that need to borrow from the Federal Loan Account that is funded by FUTA?

* What happens to states that may experience a temporary shortfall in funds needed to administer their programs?

The Extended Benefit Program has not worked as employers had hoped when we supported its enactment. We had hoped that Congress would rely on this program and not enact special supplemental "emergency" benefit programs every time it perceived a serious unemployment problem. This has turned out to be a naive hope. Fortunately, many times when Congress has enacted these "emergency" supplemental benefit programs it has recognized that they should be financed from general revenue and not by employer payroll taxes.

Some proponents of devolution have contended that many states will be able to reduce employer taxes that fund employment security administration. The savings, which it has been estimated could amount to as much as $291 million annually, would result from joint filing of FUTA taxes and state taxes with one collection agent, the state. However, if a state with a higher wage base than the federal base of $7,000 used its higher base for calculating the administrative tax, this would result in some shifting of the tax burden to higher wage employers.

It should be noted that regardless of how the administration tax is calculated many proposals still require all state employment security taxes, both for administration and benefits, would still

be deposited in the Federal Unemployment Trust Funds and so would still be in the Unified Federal Budget for purposes of deficit calculations.

As to the Loan Account, it has been suggested that funds currently in the account be used to create a revolving fund since states must repay loans with interest. If at some point additional funds to pay U.C. benefits were needed, repayable advances could be made from general revenue, as has been done in the past. More recent experience has shown that states are hesitant to use this fund and have adopted alternative funding mechanisms. This same approach (repayable advances), should it ever occur, could be used to assist in financing temporary shortfalls in administrative funds.

Regardless of the exact method, which requires much attention to detail, employers must be relieved of the present double taxation.

Need to Overrule Pennington Decision on Base Period

We support amending the Social Security Act to provide that determination of a state's base period is a decision that should be left to the state. This would overrule the decision of the Seventh Circuit Court of Appeals in the case of Pennington v. Doherty. This decision held invalid Illinois' use of a base period of the first 4 of the last 5 completed calendar quarters to determine if the wages earned by the claimant were sufficient to qualify for unemployment compensation. This is the definition of base period used by most states. However, a few states use an alternative base of the last 4 completed quarters if it results in more favorable treatment for the claimant. Pennington claimed, and the Circuit Court agreed, that since it is technically feasible for Illinois to use this alternative base period, its failure to do so violates section 303(a)(1) of the Social Security Act which requires a state unemployment compensation program to provide for such methods of administration that are found by the Secretary of Labor to insure full payments of unemployment compensation when due. The Secretary of Labor has never found that the first 4 of the last 5 completed calendar quarter base period violated this provision, but the 7th Circuit Court did. We feel this is a matter that is best left to each state to decide what will work best in its particular case.

Conclusion

We appreciate this opportunity to appear before your Subcommittee today and look forward to working with you to develop a proposal to reduce taxes. If I or any member of our Coalition can be of service to you in your deliberations we are ready to assist in any way we can.

The Coalition for U.C. Tax Reform

AT&T
Acordia of Ohio
American Automobile Manufacturers Assoc.
American Iron and Steel Institute
American Payroll Association
Ames Department Stores, Inc.
Armco, Inc.
Associated Builders and Contractors, Inc.
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East Alco
Eastman Kodak Company
Employer's Unemployment Compensation Task Force
Employer's Unemployment Compensation Council
Employers Group
Employers Service Corporation
Employers Unity, Inc.
Federated Department Stores
Food Marketing Institute
Frank Gates Service Company
Frick Company
Gates McDonald
Georgia-Pacific Corporation
Gibbens Company
Grainger Manufacturing
Gulf Copper Manufacturing Corp.
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Harrington Services
Heat Transfer Equipment Company
Heiss, Gibbons & Company, Inc.
Herbruck Poultry Ranch, Inc.
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Illinois State Chamber of Commerce
Indiana Manufacturers Association
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Liberty Mutual Group
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MS Manufacturers Assn.
Management Assoc. of Illinois
Marriott International, Inc.
Martin Boyer Company, Inc.
Maryland Benefit Advisors, Inc.
Maryland Chamber of Commerce
Masco Corporation
May Department Stores
Meredith Corporation
Met Life Insurance
MI Health & Hospital Assn. Service Corp.
Michigan Manufacturers Association
Mississippi Hospital Association
Mississippi Manufacturers Association
Missouri Merchants & Manufacturer's Assn.
Monsanto Company
Nat'l Assn. of Professional Employee Orgs.
National Association of Manufacturers
Nat'l Federation of Independent Business
New Jersey Business & Industry Assn.
NM Association of Commerce & Industry
Ohio Chamber of Commerce
Ohio Manufacturers' Association
Oklahoma State Chamber
Oneida Ltd.
PA Chamber of Business and Industry
PPG Industries, Inc.
Paradise Valley Golf Club, Inc.
Pennsylvania Manufacturers Association
Pfizer, Inc.
Pratt & Lambert United
Procter & Gamble Company
Rockwell International Corporation
Ryder Systems, Inc.
Sears
Sherwin-Williams Company
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TRW, Inc.
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U.S. Chamber of Commerce
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Varian Associates
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HISTORY OF 0.2% FUTA SURTAX

October 1976	0.2% surtax enacted to pay EUCA debt ($6.2 billion at that time). EUCA debt grew to $8.6 billion in 1977. Projection: Tax was to be paid for 5 years and retire the existing debt ($6.2 billion)
August 1982	0.2% surtax extended until debt is repaid.
May 1987	Debt repaid -- 10 years and 5 months after the 0.2% tax was enacted. The 0.2% tax was to terminate at the end of 1987.
December 1987	0.2% surtax extended for 3 years -- through 1990 -- to build EUCA and offset deficit.
November 1990	0.2% surtax extended for 5 years -- through December 1995 -- to build EUCA and offset deficit.
November 1991	0.2% surtax extended for 1 year -- through December 1996 -- to offset deficit and build EUCA.
August 1993	0.2% surtax extended for 2 years -- through December 1998 -- to build EUCA and offset deficit.
March 1994	Clinton Administration proposes a permanent extension of the 0.2% surtax -- to be used to fund a new FUTA account (Reemployment Training Assistance Account) from which income support, while in training, could be paid for up to 78 weeks (including regular and extended benefits, if available).
March 1996	Clinton Administration proposes an extension of the 0.2% surtax through December 31, 2006. The stated purpose of this extension is to support the continued solvency of the Federal unemployment trust funds and maintain the ability of the unemployment system to adjust to economic downturns.

Mr. CAMP. Thank you for your comments.

Walter Curt, president of Shenandoah Electronic Intelligence.

STATEMENT OF WALTER CURT, PRESIDENT, SHENANDOAH ELECTRONIC INTELLIGENCE, INC., HARRISONBURG, VIRGINIA

Mr. CURT. Distinguished Members of the Subcommittee, my name is Walter Curt. I am president of SEI, Inc. It is an electronics, research, and development firm located in Harrisonburg, Virginia.

I am privileged by your invitation to offer the perspective of a small business man and an interested citizen on the topic of unemployment insurance reform.

At the beginning, let me say that I believe our Federal/State system of unemployment insurance has generally served us well since it was created in 1935. Tens of millions of workers who have lost their jobs without fault have been sustained with temporary assistance until returning to gainful employment. This has often kept families from losing their homes or automobiles or suffering the indignity of public assistance. At the same time, the limited benefits and work search requirements help keep the program a bridge to reemployment rather than a path to welfare dependency.

While it is not uncommon for employers, me included, to complain about individual cases, few question the wisdom and necessity of a sound national system of unemployment insurance, nor do I think employers as a whole object to paying reasonable charges to support an efficient system.

My purpose in appearing today, therefore, is not to advocate the elimination or curtailment of America's unemployment system. I am here instead to discuss ways the program can be improved by reducing unnecessary tax and paperwork burdens.

As you know, employers pay not one, but two unemployment insurance taxes. First is the employer payroll tax imposed by each State to pay the actual benefits to the jobless. Taxes everywhere are experience rated, rising or falling for each employer depending on its layoff record, in much the same way motorists' automobile insurance premiums vary with their driving records.

Less well known is the employer payroll tax levied by Congress under the Federal Unemployment Tax Act, also known as FUTA. The FUTA tax is intended primarily to finance program administration through Federal grants to States to maintain State unemployment offices and pay their workers. Paperwork on these taxes is estimated to cost American employers about $300 million annually or up to $500 million as we have heard here today. That does not include $70 million in FUTA revenues for the fiscal year 1994 used to pay the IRS to collect the tax.

The problem is the gulf between the FUTA revenue collected and the amount returned to the States as administrative grants. According to the U.S. Department of Labor in fiscal 1996, national FUTA revenues are expected to total about $6 billion with only $3.5 billion, or 62 percent, being sent back to the States to run the programs.

This disparity is often wider for individual States. For example, in fiscal year 1994, employers in my own State, the Commonwealth of Virginia, paid an estimated $140 million in FUTA taxes, but

only $60 million, or 42 percent, was returned to run the Virginia Employment Commission.

We have heard about Indiana and their ratio today and how poor that is, but overall in fiscal year 1994, only five States and the Virgin Islands were winners, getting back more than they paid in, while 45 States, including the District of Columbia and Puerto Rico, were losers in this lottery.

What happens to the rest of the money? A relatively small amount estimated at $50 million for fiscal year 1996 is expected to be spent to finance the Federal share of extended benefits to workers in certain States in times of high unemployment while $250 million is expected to be on loan to State trust funds with solvency problems. That will leave an estimated $15 billion in FUTA revenues in Federal trust fund accounts at the end of the fiscal year.

Another problem is the inefficiency created under the current system. For instance, rather than receiving a single, annual Federal grant, each State receives funds through several single-purpose grants. This makes it impossible to achieve economies of scale by using equipment or personnel funded under one grant to provide customers with services designated for financing under another program.

Federal grants are inevitably accompanied by a welter of regulations, restrictions, and reporting requirements. While some Federal oversight is reasonable, much of the regulation by the Department of Labor is needless or even counterproductive.

Several detailed and technical proposals have been advanced for unemployment insurance reform. Here are three broad principles that I hope can form a basis for further discussion.

First, let States finance the administration of their own State unemployment offices. Nearly every State would be able to impose a much lower tax on employers and raise revenue equal to or greater than the amounts it currently receives in Federal grants.

Second, end the Federal/State extended benefits system and close the Federal trust fund accounts for administration. Extend the benefits and loans to State benefit funds distributing the nearly $15 billion on hand to individual State trust fund accounts.

State accounts would receive a massive infusion of assets. That would permit in most cases the reduction of existing State taxes, increases in benefits, or both.

Third, pare the Federal oversight back to the essentials, while retaining important protections such as minimum national standards for employer coverage and Federal requirements for fair hearings for individuals whose claims have been denied.

As I said earlier, employers do not object to paying reasonable taxes to support an efficient system of employment security. The current figures suggest that employers may be overpaying $2 billion a year in taxes, resulting in the accumulation of nearly $15 billion in idle funds to finance a system that lacks the flexibility to make the best use of the funds it does receive.

I firmly believe reform along the lines I have suggested will produce a fairer policy for employers and a more supportive system for jobless Americans.

Thank you.

[The prepared statement follows:]

STATEMENT OF WALTER CURT
PRESIDENT
SEI, INC.

Chairman Shaw, Members of the subcommittee, my name is Walter Curt. I am President of SEI, Inc., an electronics research and development firm with headquarters in Harrisonburg, Virginia.

I am privileged by your invitation to offer the perspective of a small businessman and interested citizen as you take up the topic of unemployment insurance reform.

At the beginning, let me say that I believe our federal-state system of unemployment insurance has generally served us well since it was created in 1935. Tens of millions of workers who have lost their jobs without fault have been sustained with temporary assistance until returning to gainful employment. This has often prevented families losing their homes or automobiles or suffering the indignity of public assistance. At the same time, the limited duration and amount of benefits, as well as work search requirements, help ensure that the program is a bridge to reemployment rather than a path to welfare dependency.[1]

While it is not uncommon for employers (me included) to complain about an individual adjudication of benefit eligibility, few question the wisdom and necessity of a sound national system of unemployment insurance. Nor do I think employers as a whole object to paying reasonable charges to support an efficient system.

My purpose in appearing today, therefore, is not to advocate the elimination or curtailment of America's unemployment system, which is expected to serve more than 9 million people and distribute more than $24 billion in benefits during the current fiscal year[2]. I am here instead to explore with you ways in which the program can be improved by reducing *unnecessary* tax and paperwork burdens on employers, and streamlining administration to enhance services to the out-of-work.

The Two-Tax System

As you are aware, employers pay not one but two unemployment insurance taxes.

The State Tax: The most familiar and visible tax is an employer payroll tax imposed by each state to pay the actual benefits to the jobless. Each state legislature determines the tax rate range. Taxes everywhere are "experience rated," rising or falling for each employer depending on its layoff record, in much the same way motorists' automobile insurance premiums vary with their driving records.

The Federal Tax: Less well known is a second employer payroll tax, levied by Congress under the Federal Unemployment Tax Act (FUTA), that is intended primarily to finance program administration, in the form of federal grants to states enabling them to maintain state unemployment offices and pay their workers. This tax is imposed at an effective flat rate of 0.8 percent[3] on the first $7,000 in wages earned by each worker employed by a covered employer.[4]

Of course, employers must also file two tax returns, a quarterly return to the state, and an annual return to the federal government. This duplicative paperwork exercise has been estimated to cost American employers collectively

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[1] 'According to the U.S. Department of Labor, the FY1996 average duration of benefits is expected to be only 14.7 weeks. *UI Outlook*, March 1996, Key Data Summary.

[2] Ibid.

[3] The gross tax rate is 6.2 percent, but all employers in all states that have programs meeting certain federal conditions receive a 5.4 percent tax credit. All states have approved programs and thus all covered employers enjoy the tax credit. The 6.2 percent rate also includes a 0.2 percent surtax that now extends until January 1, 1999.

[4] "In 1994, about 108 million workers — 98 percent of all wage and salary workers and 90 percent of all employed individuals — were covered by the (unemployment insurance) system." *How the Unemployment Compensation System Works*, Congressional Research Service, The Library of Congress, Sept. 2, 1994, p. CRS-2.

about $291 million annually.[5] That does not include $72.6 million in FUTA revenues (FY1994) used to pay the Internal Revenue Service to collect the tax.[6]

The Problem of Overtaxation

The federal problem of overtaxation focuses on the gulf between the revenue collected from employers under the FUTA tax and the amount appropriated to the states in the form of administrative grants to operate the system. According to the U.S. Department of Labor, in FY1996, national FUTA revenues are expected to total $5.74 billion, while only $3.54 billion, or 62 percent, will be sent back to the states to run the program.[7]

Since actual grants to individual states are determined according to complicated formulas administered by the Labor Department, the disparity is often far wider when the FUTA revenue collected from employers in a particular state is compared with the grant money received by the state for program management. For example, in FY1994, the last year for which such state-by-state figures are available, employers in my own state, the Commonwealth of Virginia, paid an estimated $142.6 million in FUTA taxes, but only $60 million, or 42.1 percent, was returned to run the Virginia Employment Commission. Indiana received only 37.5 percent of the revenue produced from its employers, the poorest ratio of any state. Overall, in FY1994, only five states and the Virgin Islands were "winners," receiving more in grant funds than their employers paid in taxes, while 45 states, the District of Columbia, and Puerto Rico, were "losers."

What happens to the rest of the money?

A relatively small amount, estimated at $50 million for FY1996,[8] is expected to be spent to finance the federal share of extended benefits to workers in certain states in times of high unemployment, while $250 million is expected to be on loan to state trust funds with solvency problems.[9] That will leave an estimated balance of $14.97 billion in FUTA revenues in federal trust fund accounts at the end of FY1996![10]

The Problem of Inefficient Administration

Even more than taxpaying employers, the jobless have a concrete interest in efficient operation of the unemployment system because, to a degree, their livelihoods and career prospects depend on it. "Unemployment Office" is a misnomer, since services provided go well beyond taking and paying claims: Employment services are offered to anyone seeking a job change, and critical labor market information is furnished to employers and the general public. So in a sense, everyone has a stake in what is more aptly described as the employment security system.

Here are a few brief examples of some of the problems and inequities in the system as it operates now:

- Rather than receiving a single annual federal grant to support its employment security system, each state receives funds through several grants, one for unemployment insurance administration, one for the employment service, and several for the collection and dissemination of labor market information. The existence of distinct funding streams makes it impossible to achieve economies of scale by using equipment or personnel funded under one

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[5] *Devolution, Governor George Allen's Proposal to Transfer the Administration and Financing of the Employment Security System to the States*, Third Revision, p. 6.

[6] Ibid., p. 3, citing U.S. Department of Labor figures.

[7] *UI Outlook*, p. 5.

[8] Under the program, the federal and state governments share equally the cost of extending benefits for eligible claimants by up to 13 weeks. Normal maximum eligibility is 26 weeks.

[9] *UI Outlook*, p. 15.

[10] Ibid., pp. 13-15.

grant to provide customers with services designated for financing under another. For example, a computer obtained for use in processing unemployment claims cannot be used to help a job applicant find new work.

- Federal grants are inevitably accompanied by a welter of regulations, restrictions, and reporting requirements. While some federal oversight is reasonable, much of the regulation by the Department of Labor is needless or even counterproductive.

- The Labor Department's allocation formulas for its unemployment insurance grants create perverse incentives by rewarding states with more money the longer it takes to process an average insurance claim. This discourages automation and innovation.

Sensible Unemployment Insurance Reform

Several detailed and technical proposals have been advanced for unemployment insurance reform. Rather than addressing these or offering a complete blueprint of my own, I would like to outline three broad principles of reform I hope can form a basis for further discussion.

First: Give responsibility to the states to finance administration of their own state unemployment offices. Each state legislature would decide how large a state tax to impose upon employers to bring in sufficient revenue to support its own system. Nearly all states would be able to impose a much lower tax on employers and raise revenue equal to, or greater than, the amounts they currently receive in federal grants.[11] Dual tax returns would no longer need to be filed, and problems associated with multiple funding streams would disappear.

Second: End the federal-state extended benefit system, and close the federal trust fund accounts for administration, extended benefits, and loans to state benefit funds, distributing the nearly $15 billion on hand to individual state trust fund accounts. State accounts would receive a massive infusion of assets that would permit in most cases the reduction of existing state taxes that finance benefits, increases in benefits, or both. States would also have the option of introducing their own extended benefit programs and determining the conditions under which they would become effective. Loans to insolvent state trust funds could be made from federal general revenues.

Third: Pare back to the essentials federal oversight rules, while retaining important, substantive protections, such as minimum national standards for employer coverage and federal requirements for fair hearings for individuals whose claims are denied.

Conclusion

As I said earlier, employers do not object to paying reasonable taxes to support an efficient system of employment security. But current figures suggest that employers may be overpaying $2.2 billion a year in taxes, resulting in the accumulation of nearly $15 billion in idle funds, to finance a system that lacks the flexibility to make the best use of the funds it does receive. I firmly believe reform along the lines I have suggested will produce a system not only fairer to taxpaying employers, but also more effective in serving its primary client, jobless Americans.

[11] More than sufficient funds exist in federal accounts to hold harmless at current funding levels the six "winner" jurisdictions for a five-year transition period.

Mr. CAMP. Thank you very much.

Mr. Rangel, would you like to inquire?

Mr. RANGEL. Yes. We are moving quickly into a period where a lot of people believe that the States are in a better position to take care of problems that are local, and we are getting involved in the block grant proposals which reduces the size of the Federal expenditures, as well as their interference, because in the areas of health care and welfare reform we say trust the Governors. After all, you haven't done a good job.

If we block grant it, we will be in the posture of having to determine how to redistribute the money, and the easiest way is that you get back what you put in. Then, when we run for reelection, whether it is health care or unemployment or welfare, ultimately we could say we are getting out of this Federal interference, Governors know best, States know best, why don't you just take care of your own. Tax what you think is fair, and then we will really reduce dramatically the Federal tax.

It is just a step further, I think, from what you are talking about. If we are abusing the system, not giving you back your fair return, trust your State legislators in doing the right thing. Keep your own employers' tax money. Take care of your own unemployed, and let us just get on with the national defense.

Do any of you object to just taking that extra step, and if so, why?

Mr. POYTHRESS. I think you described the system that we are recommending.

Mr. RANGEL. That the Federal Government not collect, not do anything, just say whatever we are doing, just repeal the law. You don't touch your employment taxes. Let the States do it.

Mr. POYTHRESS. No. No, that is not the recommendation at all. The recommendation——

Mr. RANGEL. Well, I am saying that is what I am saying. That the next step would be that we will not be the collection agency for the States. You are smart. You are sensitive. You know how to balance budgets. We don't. So you do it.

Mr. POYTHRESS. That is what we are recommending.

Mr. RANGEL. Well, then what is it that you—where do we differ? Then the Federal Government will not collect any of your employers' taxes, right? You are recommending that?

Mr. POYTHRESS. Correct.

Mr. RANGEL. And that we will just——

Mr. POYTHRESS. Excuse me. The government would not collect it directly. Now, some of the money would be made available. Some of that money would come to the Federal Government to fund the oversight role which all of the recommendations embrace that there is a Federal oversight role.

Mr. RANGEL. Wait 1 minute. What oversight role? We are talking States rights here. So please don't agree with half of it.

I am saying take the Federal Government out of it. The Governors are oversighted.

Mr. POYTHRESS. Nobody has recommended that.

Mr. RANGEL. Why not?

Mr. POYTHRESS. Because there needs to be a national system of unemployment insurance.

Mr. RANGEL. Oh, you mean the national collection of employers' taxes, don't you?

Mr. POYTHRESS. No, I don't.

Mr. RANGEL. What role would we play? You want us to collect the taxes and then give a block grant. Have you got a formula for the redistribution of the block grant?

Mr. POYTHRESS. That is exactly what we do not wish. That is what we have now, and this changes it.

Mr. RANGEL. Well, what is it that you want?

Mr. POYTHRESS. The States to collect the tax——

Mr. RANGEL. Yes.

Mr. POYTHRESS [continuing]. To keep in the State the amount that they collect to run State activities, subject to the reallocation of a portion thereof to fund the necessary portion of the Federal Government's role.

Mr. RANGEL. What Federal Government's role?

Mr. POYTHRESS. The U.S. Department of Labor.

Mr. RANGEL. What?

Mr. BLUE. None of us have recommended that the Federal Government be taken entirely out of a national unemployment system.

Mr. RANGEL. Why not?

Mr. BLUE. I think there is a role in the States for the Federal Government.

Mr. RANGEL. What role?

Mr. BLUE. The role is being one of being sure that States are complying with certain requirements.

Mr. RANGEL. Oh, no. We trust the Governors. Now, cut out that business. We have screwed it up. Let the Governors do it.

Mr. BLUE. I suspect if you would want to go that far, there would probably be a lot of people who would be in favor of it.

Mr. RANGEL. Well, let me ask you this.

Mr. POYTHRESS. There is a new party out there, I think, that has recommended that——

Mr. RANGEL. Well, let me ask you this. Those that reflect business now, do you think we would find employers, not feeling good about saying it, because no one likes to pay taxes to the Federal Government? So, if you want to pick up a vote or two, not the Federal Government. Do you think there would be employers that would want 50 States deciding what the benefits are going to be?

Mr. BLUE. No. The States decide that now. That is a State issue right now.

Mr. RANGEL. Then we could really keep the Federal Government out of oversight. What would you want us to do in providing oversight?

Mr. CURT. Let me mention a couple of things.

Mr. RANGEL. What?

Mr. CURT. You mentioned, one, that you thought you had failed or that the system had failed. I don't think this system has really failed.

Mr. RANGEL. Oh, I shouldn't have said that.

Mr. CURT. I think it has been very successful.

Mr. RANGEL. What reason should we stay in it and all of this, extended benefits?

Mr. CURT. Well, you are really not in it now. The States collect the taxes. The Federal Government collects the taxes, but the State really distributes the money, handles all the administrative work right now.

All I am proposing, at least to some extent, is that the excess money that the Federal Government collects just stay in the States; that the function of the Labor Department pretty much stay the same as it is now, but the excess money stay in the States, and the States pick up more of a responsibility, but not to wipe out the whole system. I think it has been very successful.

Mr. RANGEL. Well, I just don't see why we should be involved in this if the States believe they can do a better job.

How about extended benefits? Is there a Federal role in that, or could the States handle that, too, just collect the money?

Mr. BLUE. Well, the Extended Benefits Program which, by the way, was supported by employers, just simply hasn't worked——

Mr. RANGEL. So we can drop it.

Mr. BLUE [continuing]. Because every time something happens, Congress decides they are going to go ahead and do something in addition to the Extended Benefits Program.

Mr. RANGEL. So we can drop that.

Mr. BLUE. So I think you could drop that.

Mr. RANGEL. All agree?

Mr. BLUE. I think that could probably be dropped, yes.

Mr. RANGEL. So, really, after all the testimony is done, forgetting what little we are doing, you can tell me what is it besides oversight and monitoring you. What would the sanctions be if you didn't, besides pay the money that you didn't put up——

Mr. CURT. Well, I think the proposal would——

Mr. RANGEL [continuing]. Or pay the money that you lost because of a State recession, but besides being your insurance policy, what could we do?

Mr. CURT. I think the proposal calls for leaving the trust fund money still sort of in control of the Federal Government.

Mr. RANGEL. Why?

Mr. CURT. It is the safest place to put it, I would say.

Mr. RANGEL. You have to trust the States, and you have to trust the—you don't have deficits. We have them.

Mr. CURT. As far as I am concerned, in Virginia, I would be perfectly comfortable with you giving our portion back to Virginia.

Mr. RANGEL. Good. There is no one that objects to that.

Mr. CURT. But you were asking what sanctions. The proposal basically says the Federal Government could, if they needed to, access that trust fund and withhold money or change the scope of the money that was going to States that were not in line.

Mr. RANGEL. OK. Well, listen, the red light is on.

I hope you send to me, besides all of the things that you can do better, the limited role that you do see the Federal Government can and should be doing.

Mr. BLUE. And that is part of the proposal.

Mr. RANGEL. Because you would have to agree with me it is frustrating to get all of this money from Federal citizens and then turn welfare over to them, Medicaid over to them, soon Medicare, whatever is left of it, and just have us in the role of oversight. Let us

find out whether we can get back to where we used to be, where we have States in charge of their own rights as relates to this specifically.

Thank you.

Mr. CAMP. Thank you.

Mr. Collins may inquire.

Mr. COLLINS. Thank you, Mr. Chairman.

First of all, I would like to welcome Commissioner David Poythress, the Labor Commissioner of Georgia. Not only is he well-knowledged in the area of Department of Labor, but he has a history and background in the area of Medicaid, too, because at one time he was the Commissioner of Medical Assistance for the State of Georgia. As a county commissioner back at that time, he was very helpful to me in many ways when I approached him with questions and problems that we had.

Commissioner Poythress, what are the advantages to employers that you see in the proposal that you outline, also to taxpayers and to employers?

Mr. POYTHRESS. The advantage to the employer most immediately is they pay only one tax, or at least they fill out only one tax return, write one check, and are subjected to only one audit.

The administrative costs to the business community are hard to estimate, but they run to the hundreds of millions of dollars, which would be saved.

Second, the proposal would position the States to do two things. First, as Mr. Blue pointed out, the proposal would make available to State agencies more funds to run their own operations, and there are agencies, mine among them, who are feeling very financially strapped these days to pay administrative costs, but more importantly, it would position the States to authorize very, very substantial tax cuts. That is to say, the amount of money collected for the administration of the program could be cut by, in some States, as much as 60 or 50 percent.

Mr. COLLINS. What about employees, the folks who would become unemployed and seek benefits? Do you see any danger to them?

Mr. POYTHRESS. It would be invisible to them. It would be invisible to them.

Mr. COLLINS. Do you see an enhancement to them, possibly?

Mr. POYTHRESS. Well, there could be an enhancement in terms of improved efficiencies in the State. If the State had more money and had less—or should I say, more flexibility in terms of managing its own administrative affairs.

Mr. COLLINS. Based on our scoring techniques on revenues if we are going to devolve this tax back to the States, how could we remedy the fact that today we use those funds to cover part of the deficit?

Mr. POYTHRESS. My proposal is that the trust fund moneys be reallocated to either the State benefit accounts or the State administrative accounts, both of which would be maintained by the U.S. Treasury Department.

The benefit account funds are now scored as part of the national asset side of the balance sheet, as I understand it.

It has been suggested that if the administrative accounts were treated the same way, though, they could not be scored as being

part of the asset side of the balance sheet, and I don't understand that.

It seems to me that if you have the benefit money and this trust and the administration money and a trust that is exactly like it, how can one count and the other not? I think they should both count and be counted against the national debt.

Now, the bigger question, I think, goes to what happens when the States bleed down the accounts, as they surely would. The tax cut that I am talking about would result in long-term diminution in the size of those trusts, and I think that is just a judgment that the Congress has got to make.

As Mr. Curt pointed out and as we have all pointed out, those funds serve very little useful purpose at this point except to minimize the apparent size of the national debt, even though they can only be spent for the specific purposes for which they were collected. Their presence simply masks the size of the national debt.

Mr. COLLINS. In other words, get back to truth in budgeting.

There are a variety of State proposals along these lines. How would you characterize the major differences between the various State proposals?

Mr. POYTHRESS. Minimal. The differences between—there are three proposals out there, New Hampshire, Virginia, and Georgia. We talk continually among ourselves, the three players in those States, and I believe it would be fair to say that at this point the differences are minimal and could be resolved easily through the legislative process.

Mr. COLLINS. You mentioned the *Pennington* decision. I think you went straight to the heart of why there are a lot of people that would like to retain or uphold the *Pennington* decision. You mentioned the word "welfare" versus insurance benefits. There are a lot of people in this town who like to use the dependency of the welfare system. If they can create additional welfare systems, it helps to enhance their reelection to come back here and govern and control those benefits.

Again, I appreciate the job you do for the people of the State of Georgia and your efforts in this proposal.

Mr. POYTHRESS. Thank you.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. CAMP. Thank you.

Mr. English.

Mr. ENGLISH. No questions, Mr. Chairman.

Mr. CAMP. Thank you.

Mr. Nussle.

Mr. NUSSLE. Yes. I just want to thank the panel for coming forward with some good ideas. It is a complicated issue, and yet, there are some seemingly commonsense solutions to it that you have come forward with.

I just want to show my appreciation for those ideas and just ask one thing about when it comes to the devolution issue. You were kind of getting into it a little bit with Mr. Rangel, but I want to be clear on what you envision within your proposal would be the Federal role and give you an opportunity to answer it without getting hit.

What will we still be doing?

Mr. POYTHRESS. I would say not much different from what you are doing now.

I think, and while we love our friends in the U.S. Department of Labor, many of us feel like there are parts of it that are overstaffed, specifically the field offices which were created in an earlier time when communications are not what they are today. We feel like it could be significantly downsized, if not eliminated, but as Mr. Blue said and as all of these proposals contemplate, there is a requirement for a consistent—reasonably consistent national policy as far as an unemployment system is concerned, and we would see that as essentially staying in place, not being qualitatively different from what it is today.

Mr. BLUE. If I can comment, what you are really doing for the most part is eliminating the jobs in the employment and training division, the UI division, of people who sit and try to find a way to reallocate this money back to the State agencies of which none of the State agencies are happy with for the most part. There are people sitting there looking at unit cost and so forth, and obviously if this were accomplished, that wouldn't be necessary anymore.

For the most part, the rest of the functions of DOL would probably remain in place.

Mr. NUSSLE. Go ahead.

Mr. CURT. There is one other aspect of it, and that would be the reduction of the Internal Revenue Service requirements.

Mr. BLUE. Yes.

Mr. CURT. If you got rid of the IRS secondary collection, you could significantly reduce the effort and the labor involved in that in terms of the IRS.

Mr. NUSSLE. All right. I am just keeping a mental list here, as well as on paper. IRS jobs are at stake. DOL jobs are at stake, and I haven't heard anybody yet at least—and this is what we need to find out, if there is anyone who disagrees with the efficiencies that you have outlined here vis-a-vis allowing the States to continue their role, but basically taking over the administration of these different proposals as you have outlined them.

The third, of course, is that we don't have as much money out here to play with, to make the deficit look smaller, which means it is not that the deficit looks smaller. It means that money can be used for something other than labor or unemployment benefits or issues. We can build roads and we can do whatever.

Mr. BLUE. You have the money. You just decided because you are siphoning it off as it comes through here and it goes back to the States, about 40 percent of it.

Let me make an observation. Something that I believe could be utilized for the use of those funds by the States, which is not being done now, is the effort to obtain jobs for claimants.

State agencies are not doing a good job, and there are a lot of reasons for that, about getting claimants jobs. The statistics show that since 1975 up through 1993, even though the insured unemployment rate has gone from 6.1 to 2.6, the average duration of people who are on unemployment, average duration has not changed one whit, 15.7, 15.9, 15.9. How could this be when the unemployment rate has gone down and the insured unemployment

rate by one-third, yet everybody is still collecting benefits for the same period of time?

It is our philosophy that if we can turn this back to the States and they can use their funds properly that they will be able to obtain jobs for claimants; that the employer will have less cost; that the government will collect more money because they will be paying taxes on their wages; and the system will have credibility.

One way of doing that is a system which is now in place, but not well financed. It is profiling. I am sure that Mr. Poythress could probably comment on that.

Getting people jobs who are unemployed claimants is one of the targets the employers are looking for in this system.

Mr. NUSSLE. Thanks. Thank you.

Chairman SHAW. Does anyone have anything further?

Mr. Collins.

Mr. COLLINS. No questions.

Chairman SHAW. OK. I want to thank the panel for being with us this morning.

There is a vote on the floor, which I understand is a rule on HHS. The Subcommittee will recess for approximately 15 minutes while we go vote. We will come right back, and at that time we will bring the third and final panel before the Subcommittee.

[Recess.]

Chairman SHAW. If we could go ahead and get started, we have Mr. English. We are awaiting Mr. Upton and Mr. Farr, and Mr. Heston is now with us.

If you would like to take a seat at the witness table, I think you and Mr. English will be, in part, talking about the same subject.

Mr. English.

STATEMENT OF HON. PHILIP S. ENGLISH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. ENGLISH. Thank you, Mr. Chairman, and thank you for the opportunity to testify today and for holding this hearing on a variety of necessary unemployment insurance reforms.

As you may know, prior to being elected to Congress, I served briefly as research director for the Senate of Pennsylvania's Labor and Industry Committee. During my service, I dealt with many of the issues being discussed today, and I can tell you from my own hands-on experience that the current UC system is badly in need of reform.

States are not equipped to tackle unemployment in the nineties with an unemployment insurance system that has changed very little since its inception and cannot deal effectively with the changing nature of unemployment. I will discuss several changes to the system that I am proposing, as well as unfair taxation of benefits.

Late last month, Mr. Chairman, I introduced legislation designed to empower States to meet the needs of the long-term unemployed. The current unemployment insurance system was created to help States combat short-term unemployment. Unfortunately, workers who are laid off from their jobs now are less likely to return to their previous jobs than in the past, and long-term unemployment is increasing. The current system cannot adequately address long-term unemployment.

Unemployment is hard enough on families without the worry that benefits will not be available because of the arcane structure of the system. H.R. 3738, the legislation that I introduced, will make several significant changes in the current system.

First of all, it will make it easier for States to provide extended unemployment benefits to workers who have been unemployed for long periods of time by broadening the trigger States can use to access benefits.

Research has shown that the combination of the reduction of the insured unemployment rate and the increase in the trigger level during the recession of the eighties resulted in the failure of the Extended Benefits Program to trigger on as unemployment continued to rise.

As a result, Congress found it necessary to pass a series of emergency extensions of UI benefits. Put simply, no State was able to tap into EB during the most recent recession. Therefore, it is necessary, in my view, to reform the program prior to the onset of the next recession. Emergency extensions of the benefits are a jerry-built policy prescription, neither well timed nor well targeted. Our best guess is that by lowering the trigger 1 percent the next few years, 16 States might benefit.

During 1991 and 1992, my home State of Pennsylvania, if this trigger had been in place, would have been able to offer workers an additional 13 weeks of benefits. Other changes proposed in this bill are, one, to encourage States to achieve forward funding of unemployment insurance by maintaining sufficient Unemployment Trust Fund balances to cover the needs of unemployed workers in the event of a recession. States that maintain adequate reserves based on their own experience to cover expenses in future recessions would receive slightly increased interest earnings on the part of their trust fund. States that fall short would receive slightly reduced interest earnings.

Another change we would propose is to allow interest-free cash flow, Federal loans only for States that have sufficient trust fund reserves to last through a future recession.

Another change would be to allow States to collect the Federal share of unemployment insurance taxes from employers allowing employers to fill out one form and write one check, not two, and providing a more accurate accounting of revenues collected.

Finally, this legislation would require States to distribute information packets explaining unemployment insurance eligibility conditions to unemployed individuals.

All of these provisions, Mr. Chairman, are based on the Advisory Council on Unemployment Compensation's collected findings and recommendations for 1994 through 1996.

I have concluded that if the recommendations were enacted into law as I propose in H.R. 3738, States like Pennsylvania would have the tools to assist workers faced with long-term unemployment.

I am particularly concerned about forward funding, Mr. Chairman. When I served as a staffperson, we had a $1 billion debt to the Federal Government hanging over Pennsylvania like a sword of Damocles. We need to have incentives built into the system to avoid that situation in the future.

Another important issue I would like to address is the current tax on unemployment compensation benefits. Before 1979, UC benefits were excluded from the income for tax purposes. UC benefits are currently subject to tax. This is grossly unfair because the UC tax is not a tax on income. It is a tax on benefits, benefits received during one of the most difficult times in a person's life.

The UC tax hurts the economic security of workers throughout America. Our system should be structured to provide benefits to taxpayers, not dump penalties on the unemployed.

Mr. Chairman, I have talked to literally dozens of people in western Pennsylvania who have collected UC benefits and then paid taxes on the benefits as normal income. Their experiences highlight how grossly unfair the tax is.

The tax on UC kicks workers when they are down. Unemployment benefits are intended to stabilize the income of individuals and families in the face of layoffs. Yet, someone who experienced lengthy unemployment, a situation which depletes the financial reserves of most middle-class families, will face a large and usually unexpected tax liability the next year.

For many who have struggled to survive a layoff, this tax bill is the last straw. Simply allowing tax withholding on these benefits is no solution. It merely depletes the value of compensation that is already merely adequate.

I would argue, however this tax is administered, it is fundamentally inequitable and perversely burdensome to a beleaguered middle class.

Mr. Chairman, I also welcome the opportunity to testify in favor of H.R. 3677, which addresses one of the problems, kind of a unique problem, a loophole in the law that falls disproportionately on members of the acting profession. I would strongly urge that we consider action on this particular problem because it is grossly unfair on this particular profession.

Charlton Heston is here to testify with far greater experience and eloquence than I possess in this matter, but I would like to say I think this is an issue that this Subcommittee ought to act on.

Finally, Mr. Chairman, I will conclude by emphasizing my strong support for reforming our unemployment system. It is my hope that our Subcommittee will give its strongest consideration to developing legislation that will encompass many of the suggestions heard here today.

Following through on these recommendations will result in a more manageable system and a more secure U.S. work force.

Mr. Chairman, I appreciate the chance to testify, and I would like to submit my testimony in full for the record.

[The prepared statement follows:]

Testimony
The Honorable Philip S. English
before the House Ways and Means
Subcommittee on Human Resources
July 11, 1996

Mr. Chairman and fellow Members of the Subcommittee, I want to thank you for holding this important hearing and for allowing me to address my colleagues and everyone in attendance today on unemployment reform. As most of you may know, before being elected to Congress, I was the Research Director for the Senate of Pennsylvania's Labor and Industry Committee. During my tenure, I dealt with many of the issues being discussed today and I can tell you from my own hands-on experience that the current unemployment insurance (UI) system is badly in need of reform. States are not equipped to tackle unemployment in the 90's with a UI system that has changed very little since its inception and cannot deal effectively with the changing nature of unemployment. I will discuss several changes to the system I am proposing as well as the unfair taxation of benefits during my testimony today.

Late last month, I introduced legislation designed to empower states to meet the needs of the long-term unemployed. The current unemployment insurance system was created to help states combat short-term unemployment. Unfortunately, workers who are laid off from their jobs now are less likely to return to their previous jobs as in the past -- and long-term unemployment is increasing. The current system cannot adequately address long-term unemployment.

Unemployment is hard enough on families, without the worry that benefits will not be available because of the arcane structure of the system. H.R. 3738, the legislation I introduced, will make several important changes to the current system:

1.) Make it easier for states to provide extended unemployment benefits to workers who have been unemployed for long periods by broadening the trigger states can use to access benefits.

Research has shown that the combination of the reduction in the Insured Unemployment Rate and the increase in the trigger level during the recession of the 1980's resulted in the failure of the Extended Benefits program to trigger "on" as unemployment continued to rise. As a result, Congress found it necessary to pass a series of emergency extensions of UI benefits. Put simply, no state was able to tap into Extended Benefits during the most recent recession. Therefore, it is absolutely necessary to reform the program prior to the onset of the next recession. Emergency extensions of benefits are a Jerry-Built policy prescription neither well-timed nor well-targeted.

2.) Encourage states to maintain sufficient unemployment trust fund balances to cover the needs of unemployed workers in the event of a recession. States that maintain adequate reserves (based on their own experience) to cover expenses in future recessions would receive slightly increased interest earnings on part of their trust fund; states that fall short would receive slightly reduced interest earnings.

3.) Allow interest-free, cash-flow federal loans only for states that have sufficient trust fund reserves to last through a future recession.

4.) Allow states to collect the federal share of unemployment insurance taxes from employers, allowing employers to fill out one form and write one check, not two.

5.) Require states to distribute information packets explaining unemployment insurance eligibility conditions to unemployed individuals.

All of these provisions are based on the Advisory Council on Unemployment Compensation's Collected Findings and Recommendations for 1994-1996. As most of you know, the Advisory Council was established under the Emergency Unemployment Compensation Act of 1991. That law instructs the Council to evaluate the unemployment compensation program and make recommendations for improvement. The long process of drafting H.R. 3738 allowed me to utilize my experience when considering the effects each recommendation would have on the UI system. I have concluded that if the recommendations were enacted into law, as I propose in H.R. 3738, states (like Pennsylvania) would have the tools to assist workers faced with long-term unemployment.

Another important issue I would like to address is the current tax on unemployment compensation (UC) benefits. Before 1979, UC benefits were excluded from inclusion in income for tax purposes. UC benefits are currently fully subject to tax. This tax treatment, in place since 1987, puts UC benefits on a par with wages and other ordinary income in regard to income taxation. Last year, I introduced legislation, H.R. 2461, the "Unemployment Tax Repeal Act," to again exclude UC benefits from inclusion in gross income for tax purposes. The pre-1979 exclusion was upheld by Internal Revenue Service rulings based on three arguments: 1.) the law did not explicitly require taxation of UC, 2.) the benefits were viewed as part of the social welfare system and not regarded as wages, and 3.) taxation would undercut UC's income support objectives. I feel the final justification is particularly true. The UC tax is not a tax on income, it is a

tax on benefits -- benefits received during one of the most difficult times in a person's life. The UC tax hurts the economic security of workers throughout America. Our system should be structured to provide benefits to taxpayers, not dump penalties on the unemployed.

Mr. Chairman, I have talked to literally dozens of people in Western Pennsylvania who have collected unemployment benefits -- and then paid taxes on the benefits as normal income. Their experiences highlight how grossly unfair the tax is.

The tax on unemployment compensation kicks workers when they are down. Unemployment benefits are intended to stabilize the income of individuals and families in the face of layoffs. Yet someone who experiences lengthy unemployment -- a situation which depletes the financial reserves of most middle class families -- will face a large (and usually unexpected) tax liability the next year. For many who have struggled to survive a layoff, this tax bill is the last straw.

Simply allowing tax withholding on these benefits is no solution: it merely depletes the value of compensation that is already merely adequate. I would argue that however this tax is administered, it is fundamentally inequitable and perversely burdensome to a beleaguered middle class.

Mr. Chairman, I will conclude by emphasizing my strong support for reforming our unemployment system. It is my hope that our Committee will give its strongest consideration to developing legislation that will encompass many of the suggestions heard here today. Following through on these recommendations will result in a more manageable system and a more secure U.S. workforce.

Thank you for the opportunity to testify today.

Chairman SHAW. Without objection, all of the testimony will be submitted for the record.

Mr. Upton.

STATEMENT OF HON. FRED UPTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. UPTON. Thank you, Mr. Chairman. Thanks for the opportunity to testify before you today.

The bill I bring before you today, H.R. 3430, introduced by myself and Mr. Farr, is extremely simple, yet extremely important.

Under current law, cities and counties in your districts are responsible for paying unemployment benefits for folks who work as an election official, even if they only work 1 or 2 days a year.

An unemployment claim was filed against one city in Michigan by an election inspector who worked in the August primary and November general elections in 1994. Amazingly, now the city is responsible for paying unemployment benefits to this worker.

Recognizing this injustice, the Michigan State Legislature attempted to change unemployment laws in Michigan. However, the Department of Labor was quick to point out that this situation must first be corrected by amending the Federal Unemployment Tax Act known as FUTA. H.R. 3430 makes this correction in the FUTA law, and it allows the States to provide this exemption if they choose to do so.

The CBO has assured us that the bill is budget neutral. H.R. 3430 simply gives the States the freedom to run their unemployment compensation programs as they see fit. As we all know, municipal budgets are extremely tightly stretched, providing our constituents with the services that they need and deserve.

I know of no opposition to this bill. We have received many letters of support from around the country, and we appreciate your help in getting this bill out the door.

[The prepared statement and attachment follow:]

Congressman Fred Upton's Opening Statement
H.R. 3430 - Poll Worker Unemployment Reform
July 11, 1996

"The 104th Congress is looking for as many ways as possible to relieve local governments from unnecessary federal regulations. HR 3430 accomplishes this goal by eliminating the requirement that States pay unemployment compensation on the basis of services performed by election workers.

"Under current law, cities in your district are responsible for paying unemployment benefits for people who work as an election official, even if they only work two days a year. An unemployment claim was filed against one city in Michigan by an Election Inspector who worked the August Primary and November General elections in 1994. Amazingly, the city is now responsible for paying unemployment benefits to this worker.

"Recognizing this injustice, the Michigan State Legislature attempted to change unemployment laws in Michigan . However, the U.S. Department of Labor was quick to point out that this situation must first be corrected by amending the Federal Unemployment Tax Act, known as FUTA. HR 3430 makes this correction in FUTA and allows the States to provide this exemption, if they chose to do so.

"The Congressional Budget Office has assured me that this bill is budget neutral. HR 3430 simply gives the States the freedom to run their unemployment compensation programs as they see fit.

"Municipal budgets are already tightly stretched to provide your constituents with the services that they need and deserve. I know of no opposition to this bill and have received many letters of support from local governments from across the country.

"Please help get HR 3430 to the House Floor and help free local governments from a costly and unnecessary requirement."

STATE OF MICHIGAN

CANDICE S. MILLER, Secretary of State
MICHIGAN DEPARTMENT OF STATE
TREASURY BUILDING, LANSING, MICHIGAN 48918

May 14, 1996

The Honorable Bill Archer
Chairman, Ways and Means Committee
United States House of Representatives
1236 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Archer:

As Michigan's Chief Elections Official, I am writing to urge your support of House Resolution (HR) 3430, introduced by Congressmen Fred Upton and Sam Farr, which deals with poll workers and unemployment benefits.

Under current Federal regulations, an elections official who files for unemployment benefits is entitled to those benefits, even though he or she may work only two or three days per year. Recently, a claim was filed against the City of Grand Rapids, Michigan, by an Elections Inspector who only worked the August Primary and the November General Election in 1994. Incredibly, the City was responsible for paying a portion of his unemployment benefits.

When our Legislature tried to amend Michigan law to remedy the problem, the U.S. Department of Labor informed them that the change would first need to be made on the Federal level. House Resolution 3430 makes the necessary changes in Federal law and allows states to make their own individual changes should they so choose.

Ordinarily, those who work in the polls are volunteers who feel working at elections is a part of their civic duty or a service to the community. They are compensated, but their position is not treated as a full-time employment opportunity. The possible abuse to our unemployment system under the current regulations places an unjust burden to our local governments. I encourage your full support of and leadership in passage of HR 3430.

Sincerely,

Candice S. Miller

Candice S. Miller
Secretary of State

c: Congressman Fred Upton
Congressman Sam Farr

Chairman SHAW. Thank you.
Mr. Farr.

STATEMENT OF HON. SAM FARR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. FARR. Thank you, Mr. Chairman.

I just want to add to Congressman Upton's comments that we found in California a pollworker who worked 1 day, but because he had retired from county business and because the job was terminated through no fault of his own—the election was over, it was a 1-day event—he was able to go back and collect $12,000 in unemployment insurance.

There is obviously a loophole. This bill closes it. It is a very simple bill. It leaves it up to the States, and it uses the same threshold that the Federal Government has determined to use in income tax and Medicare, the thousand-dollar threshold.

So we are leaving it up to the States. The State of California did repeal the law last year, but it is dependent upon Federal action. We think this bill remedies a problem, and we hope that you will move it with due haste.

Thank you.

[The prepared statement follows:]

SAM FARR
17TH DISTRICT, CALIFORNIA

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SUBCOMMITTEES:
DEPARTMENT OPERATIONS, NUTRITION, AND FOREIGN AGRICULTURE
RISK MANAGEMENT AND SPECIALTY CROPS

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STATEMENT OF CONGRESSMAN SAM FARR BEFORE HOUSE COMMITTEE ON WAYS AND MEANS SUBCOMMITTEE ON HUMAN RESOURCES JULY 11, 1996

Mr. Chairman, Members of the Subcommittee, I appreciate the opportunity to testify on behalf of H.R. 3430, legislation introduced by myself and Congressman Fred Upton, to fix a serious flaw in the unemployment compensation system.

Unemployment compensation is designed to give temporary assistance to workers who would otherwise suffer from serious economic setbacks due to generally unexpected and sudden loss of employment. It eases a tremendous burden for unemployed workers who lose their sole source of income, providing them with a small "cushion" of support while looking for a new job.

Interestingly, election poll workers -- individuals who serve their community on election day at a polling place -- are also eligible for unemployment compensation. This seems odd, since the very nature of the job is to serve for one day. Furthermore, poll workers receive a small reimbursement for their time and expenses -- usually sixty to eighty dollars -- and generally do not rely on their service as a poll worker as their main source of income.

In most cases unemployment compensation is usually reserved for long-term employees; thus, not many poll workers have qualified for these benefits. But more and more have exploited their eligibility to obtain significant compensation benefits -- creating a financial drain on local governments and increasing costs to the American taxpayer.

In my district, for example, a poll worker was eligible to receive up to $12,000 in unemployment compensation after "losing his job" when the election ended. Because he had held, and retired from, a prior job with the county elections board, the county was liable for the entire benefit -- an enormous financial burden they could scarcely afford.

States have tried to close this loophole themselves. Unfortunately, they have been hampered by the fact that only federal law can specify who is not eligible for unemployment compensation.

H.R. 3430 would allow states, if they so chose, to close this loophole. It uses a $1,000 dollar per year income threshold -- based on the income reasonably expected to be earned by the average poll worker volunteer -- to separate poll workers from longer-term, wage-based election workers. I would add that election workers earning under $1,000 per year are already exempt from paying Social Security and Medicare taxes.

Abuse of the unemployment compensation system not only costs taxpayers more money, but hurts those who have legitimate need for unemployment compensation. I thank the subcommittee for their consideration of this measure to close a costly loophole in federal law.

Chairman SHAW. Thank you. I think that presents to us a no brainer.

Mr. Heston.

STATEMENT OF CHARLTON HESTON, ON BEHALF OF THE SCREEN ACTORS GUILD, AMERICAN FEDERATION OF TELEVISION AND RADIO ARTISTS, AND WRITERS GUILD OF AMERICA, WEST, LOS ANGELES, CALIFORNIA

Mr. HESTON. Thank you, Mr. Chairman.

First, let me thank you and the Members of this Subcommittee for addressing this issue, particularly Congressman English and the other Members who have joined the sponsorate.

I am also grateful for the chance to testify not on my own behalf, but for my colleagues in the entertainment industry, in particular, my fellow senior performers represented by the Screen Actors Guild, the American Federation of Television and Radio Artists, and the veteran writers who are members of the Writers Guild of America, west.

As for me, I am an actor, writer, and director. I helped found a television actors union, now defunct, in the early days of live TV. I currently belong to four unions. I was president of one of them for six terms. I have chaired an international conference of performers unions and a presidential task force in the arts. I led a contingent of our members behind Dr. King in his march in this city in 1963. That's simply to say that this old horse knows the road.

I'm here today to express my support for H.R. 3677, which would amend a provision of section 3304 of the Federal Unemployment Tax Act. That section, as currently written and interpreted by the courts, operates to the detriment of senior entertainment industry professionals who are participants in multiemployer pension plans, depriving them of unemployment insurance benefits for which they are otherwise qualified.

To help understand this issue, let me give you some perspective on our profession. While some of us are millionaires, most struggle. The Screen Actors Guild has 82,000 members. The last figures I saw said that 80 percent of them make less than, much less than $10,000 a year. Just about every one of us, performer and writer alike, is a freelance worker. When we are employed, it is often short term and always temporary.

Artists in entertainment move from employer to employer. Periods of unemployment are a fact of life; even the best and most successful performers have lean times.

I am not just talking about motion picture and television actors, but of the writers, television and radio commercial performers, voice-over artists, broadcasters, singers; in short, the men and women whose images, voices, and words entertain and inform the Nation, indeed, the whole world, through visual and audio media and film, the art form of this century and the next.

These workers are covered by multiemployer pension plans which have been established by collective bargaining between our organizations and the producers, advertising agencies and the broadcasting entities who employ us, by agreement between the negotiating parties.

The plans are wholly funded by employer contributions. It is this unusual set of facts which creates the onerous application of section 3304 that now exists.

Parenthetically to this, let me point out that American films are overwhelmingly dominant in the world market, producing an unmatched trade surplus for our country.

Our organizations have been helping to encourage employment for seniors in support of the national interest and in ensuring that senior citizens remain active, contributing members of society. Senior images in our media make a major contribution to that objective, but such images are very rare.

Senior performers typically continue to seek employment in their chosen profession after they begin to receive the pension benefits they have earned over a lifetime of work in our industry.

Now, when the performer gets a new part, the new employer will make an additional contribution to the multiemployer pension fund, an additional contribution which will create an incremental increase in his pension plan, his monthly pension.

Should these performers later apply for unemployment benefits for which they have qualified, section 3304 requires that the amount of the benefit be offset by the total amount of the performer's pension, not just by the amount of the increase, but by the total amount of the pension. The offset will substantially reduce or even erase completely the unemployment insurance benefit. H.R. 3677 would very simply limit the offset to the amount of the increase.

We have for the Subcommittee a package of correspondence which began in December 1992 between our attorney, the California Employment Development Department, and ultimately the U.S. Department of Labor. With the Chair's permission, I ask that this package be accepted and included in the record of today's proceedings. This correspondence shows that efforts were made to correct this inequity at the State level, we hoped by administrative interpretation.

The need for congressional action was confirmed, however, in a letter dated June 9, 1993, in which the Department of Labor stated, "Offset of only the amount of pension increase would appear to be a more equitable alternative to offset of the total amount of the pension." However, the language of this statute does not permit proportional offset.

Passage of H.R. 3677 will provide the change in language we need here and provide our community with a more equitable alternative, as acknowledged by the Department of Labor.

Most significantly, the encouragement to senior artists to continue contributing to their industry, to their own self-esteem, and to America's culture would be a valuable corollary of your favorable action.

Thank you, sir.

[The prepared statement and attachments follow:]

TESTIMONY BY CHARLTON HESTON
IN SUPPORT OF H.R. 3677
BEFORE THE HOUSE SUBCOMMITTEE ON HUMAN RESOURCES
OF THE HOUSE COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES
July 11, 1996

My name's Charlton Heston.

First, Mr. Chairman, let me thank you and the members of this Subcommittee for addressing this issue and giving me the chance to testify, not on my own behalf, but for my colleagues in the entertainment industry, in particular my fellow senior performers represented by the Screen Actors Guild, the American Federation of Television and Radio Artists and the veteran writers who are members of the Writers Guild of America, west.

As for me, I'm an actor, writer and director. I helped found a TV actor's union, now defunct, in the early days of live TV. I currently belong to four unions, was president of one for six terms, chaired an international conference of performers unions and a Presidential Task Force on the arts. I led a contingent of our members behind Dr. King in his march in this city in 1963. That's simply to say that this old horse knows the road.

I'm here today to express my unconditional support for H.R. 3677 which would amend a provision of Section 3304 of the Federal Unemployment Tax Act. That Section, as currently written and interpreted by the courts, operates to the detriment of senior entertainment industry professionals who are participants in multi-employer pension plans, depriving them of unemployment insurance benefits for which they have otherwise qualified.

To help understand this issue, let me give you some perspective on our profession. While some of us are millionaires, most struggle. The Screen Actors Guild has 82,000 members. The last figures I saw said 80% of them make less than $10,000 per year. Just, about every one of us, performer and writer alike, is a freelance worker. When we're employed, it's often short term and always temporary. Artists in entertainment move from employer to employer. Periods of unemployment are a fact of life; even the best and mast successful performers and writers have lean times. I'm not just talking about motion picture and television actors, but of the writers, television and radio commercial performers, voice-over artists, broadcasters, singers -- in short, the men and women whose images, voices and words entertain and inform our nation...indeed, the whole world, through visual and audio media and film, the art form of this century and the next. These workers are covered by multi-employer pension plans which have been established by collective bargaining between our organizations and the producers, advertising agencies and broadcasting entities who employ us. By agreement between the negotiating parties, the plans are funded by employer contributions. It is this unusual set of facts which creates the onerous application of Section 3304 that now exists. (Parenthetically, let me point out that American films are overwhelmingly dominant in the world market, producing an unmatched trade surplus for our economy.)

Our organizations have been helping to encourage employment for seniors in support of the national interest in insuring that senior citizens remain active, contributing members of society. Senior images in our media make a major contribution to that objective, but such images are all too rare. Senior performers typically continue to seek employment in their chosen profession after they begin to receive the pension benefits they've earned over a lifetime of work in our industry. When the performer gets a new part, the new employer will make an additional contribution to the multi-employer pension plan -- an additional contribution which will create an incremental increase in the performer's monthly pension check. Should these performers later apply for unemployment benefits for which they've qualified, Section 3304 requires that the amount of the benefit be offset by the total amount of the performer's pension -- not just by the amount of the increase-- but by the total amount of the pension. The offset will substantially reduce or even erase completely the unemployment insurance benefit. H.R. 3677 would, very simply, limit the offset to the amount of the increase.

We have for the Subcommittee a package of correspondence which began in December 1992, between our attorney, the California Employment Development Department, and ultimately, the U.S. Department of Labor. With the Chair's permission, I ask that this package be accepted and included in the record of today's proceedings. This correspondence shows that efforts were made to correct this inequity at the state level, we hoped by administrative interpretation. The need for congressional action was confirmed, however, in a letter dated June 9, 1993, in which the Department of Labor stated:

> "Offset of only the amount of pension increase... would appear to be a more equitable alternative to offset of the total amount of the pension. However...the language of the statute does not permit proportional offset."

Passage of H.R. 3677 will provide the change in language we need here and provide our community with the more equitable alternative, as acknowledged by the Department of Labor. Most significantly, the encouragement to senior artists to continue contributing to their industry, to their own self-esteem and to America's culture will be a valuable corollary of your favorable action.

SCREEN ACTORS GUILD

July 11, 1996

Subcommittee on Human Resources
Committee on Ways and Means
United States House of Representatives
Washington, D. C.

Re: H. R. 3677

Ladies and Gentlemen:

This letter will provide a concise explanation of the problem under the current Federal Unemployment Tax Act and of the proposed solution as encompassed in H. R. 3677. While it is written with reference to the Pension Plan established through collective bargaining by the Screen Actors Guild (SAG), the basic facts are equally applicable to the American Federation of Television and Radio Artists and to the Writers Guild of America, west who are also participating in this effort.

Under the terms of the Screen Actors Guild-Producers Pension Plan (established in 1960 by negotiation between SAG and the motion picture producers) an actor who has met the minimum requirements to qualify for benefits can take normal retirement at age 65 (or early retirement as early as age 55). Having begun to receive monthly pension checks, he will probably continue to seek work as an actor. When motion picture, television film or television commercial work is obtained, the actor's employer will, in compliance with the collective bargaining agreement with SAG, contribute to the Pension Plan. Under the rules of the plan, such contributions will result in an increase in the actor's monthly pension check.

Once the actor's employment has ended, he may qualify for unemployment insurance. While he has otherwise met the qualifications for unemployment benefits, current law requires that an individual's unemployment insurance benefit be offset by his Pension benefit when

(1) he works for any employer-member of a multi-employer unit which contributed to his pension, and

(2) where that work results in an increase in benefits.

The actor's new employer is, in all probability, an employer- member of the same multi-employer unit which contributed to the actor's pension. As stated above, the new employment increased his Pension. Under the law, his unemployment benefit is subject to the offset.

It would be reasonable if the offset were limited to the amount of the increase. Unfortunately, the current law requires that the unemployment benefit be offset by the total amount of the Pension. H.R. 3677 would limit the offset to the amount of the increase.

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EXAMPLE
(for the purpose of illustration, the figures are hypothetical)

Assume that the actors's monthly pension benefit prior to his new employment was $600 per month. As a result of his new employment his monthly benefit is increased by $7 to $607 per month.

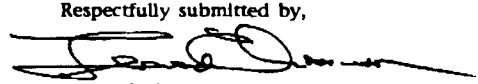
Assume that the determined unemployment insurance benefit is equal to $650 per month.

Under current law, the monthly unemployment benefit of $650 would be reduced by $607, leaving a net unemployment benefit equal to $43 per month.

Under the change encompassed in H. R. 3677, the monthly unemployment benefit of $650 would be reduced by $7, leaving a net unemployment benefit equal to $643 per month.

It is important to remember that absent the two criteria cited above (an employer in the same employer group and an increase in the pension) there would be no offset of any kind; the individual's unemployment insurance benefit would not be reduced. Accordingly, the current law discriminates against persons in our industry who enjoy the benefits of a multi-employer plan (which is essential to a freelance marketplace) and who are allowed to benefit from the fruits of their post-retirement work by virtue of the increased pension.

Respectfully submitted by,



Leonard Chassman
Hollywood Executive Director

SCREEN ACTORS GUILD

LEONARD CHASSMAN
Hollywood Executive Director

July 8, 1996

Subcommittee on Human Resources
Committee on Ways and Means
United States House of Representatives
Washington, D.C.

Re: H.R. 3677

Ladies and Gentlemen:

In conjunction with the testimony of Mr. Charlton Heston before your subcommittee on this date, we herewith submit copies of the following correspondence:

1. Letter dated December 22, 1992 from Ira L. Gottlieb, Esq. of the law firm of Taylor, Roth, Bush & Geffner (now Geffner & Bush) to Mr. Thomas P. Nagle, Director, Employment Development Department of the State of California;

2. Letter dated May 4, 1993 from Mr. Nagle to Mr. John Humphrey, Regional Director for Unemployment Insurance Services of the Employment Training Administration of the United States Department of Labor;

3. Letter dated May 17, 1996 from Mr. Gottlieb to Mr. Humphrey;

4. Letter dated June 9, 1993 from Mr. Don A. Alcar, Regional Administrator of the Employment and Training Administration of the United States Department of Labor.

Sincerely,

Leonard Chassman
Hollywood Executive Director

Encl's.

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VIA UPS NEXT DAY AIR

File No.:
11640-0041

December 22, 1992

Thomas P. Nagle
Director
Employment Development Department
800 Capital Mall
Sacramento, California 95814

RE: Unemployment offset

Dear Mr. Nagle:

This office represents the Screen Actors Guild (SAG), the American Federation of Television and Radio Artists (AFTRA) and the Writers Guild of America, west (WGA west) jointly referred to as the "Unions." Please accept the thanks of the Unions for arranging for our meeting with your representative, Marie Lopez, on October 15, 1992 in Los Angeles. The meeting proved to be worthwhile and informative. Indeed, it is partly at her suggestion that we now address our concerns directly to you, and request a meeting with you in an effort to obtain relief from a serious problem the senior members of the Unions are experiencing.

As I am sure you are aware, in this era of dual income households and high unemployment (especially in California), it is difficult for most retirees to make ends meet just with income from social security and their pensions. For this reason many retiree members of the Unions are compelled to supplement their fixed pension incomes through post-retirement employment. Unfortunately, the inherent nature of virtually all the work in the entertainment industry is seasonal, and sporadic. The competition for the few employment openings made available to performers and writers of retirement age is intense. The inevitable result of the combination of all these economic realities is that many retirees find themselves relying substantially on unemployment benefits to cover their living costs in the interim periods between what little employment they are able to find.

As if these circumstances were not difficult enough, the retiree members must overcome an additional burden in their struggle to maintain solvency and a decent living standard: in accordance with the EDD's current interpretation of applicable tax law, members' unemployment benefits will be offset by their pension benefits where they work for any employer-member of a multi-employer unit which contributed to their pension and where that work results in pension eligibility or an increase in benefits. This severely restricts the ability of many retirees to find work that will not, ironically, cause them financial hardship, and arbitrarily punishes employees who happen to work in an industry dominated by multi-employer entities. Since, as will be demonstrated below, California law requires that the pension offset be minimized to the greatest possible extent, and federal law does not require such an offset in this instance, the unions urge that the EDD adopt and apply an interpretation, consistent with the applicable statutes, that requires pension offset only where the pension employer and the base period employer are the identical, single employer.

THE APPLICABLE LAW

In 1980 Congress amended 26 U.S.C. §3304(a)(15), to read in pertinent part:

> "(A) the [pension offset] requirements of this paragraph shall apply to any pension . . . only if -
>
> (i) such pension . . . or similar payment is under a plan maintained or (contributed to) by a base period employer or chargeable employer (as determined under applicable law), and
>
> (ii) in the case of such a payment not made under the Social Security Act or the Railroad Retirement Act of 1974 . . ., services performed for such employer by the individual after the beginning of the base period (or remuneration for such services) affect eligibility for, or increase, the amount of, such pension, . . . and
>
> (B) the State law may provide for limitations on the amount of any such a reduction to take into account contributions made by the individual for the pension, . . . or other similar periodic payment. . . " (emphasis added).

The state of California is required to conform its unemployment benefits policy to federal strictures such as the pension offset

provision to maintain its federal certification, but the state legislature has left no doubt that EDD is to comply "with the letter of the federal law, and nothing more," in light of the "self-destruct" clause of Unemployment Insurance Code §1255.3(b), and the legislature's view that

> the pension offset provision was both unfair and misguided, . . . that . . . many workers pushed into early retirement actively seek() new employment . . . (and) a pension offset unfairly discriminates against workers wholly dependent upon income from pensions and unemployment compensation. . . .

Evans v. Unemployment Ins. Appeals Bd., 39 Cal.3d 398, 409, 410 (1985). The EDD is therefore under legislative and judicial mandate to maximize unemployment benefits and minimize the impact of the pension offset, as long as such policy is not inconsistent with clear federal law.

ANALYSIS OF THE PENSION OFFSET

Abiding by the legislative command to accord the federal law no more than its most restrictive, literal meaning, requires the pension offset to be operative only when the pension plan has been contributed to by the base period employer, and the work performed for "such" employer results in pension eligibility or an increase in the amount of the pension.

Thus, the offset applies where an employee works for employer A, retires with a pension, then returns to A, and as a result of the second stint, his/her pension amount increases. By the same token, if the employee worked for and retired from employer A, and then went to work for employer B, any unemployment benefits resulting from an eventual layoff from B would not be offset. Why should that result change if B happens to be in a multi-employer unit which also contains A? Given that the legislature and the Supreme Court authorize only the narrowest, leanest application of the offset, and that nothing in the federal law requires a different result in the multi-employer context, the EDD must not extend the offset to that situation.[1]

---

[1] At our October 15, 1992 meeting, Ms. Lopez stated that she was unaware of any federal law or regulation that required the EDD to maintain its current interpretation, and our research has revealed no such federal law.

The EDD's interpretation of the offset statute is broader than is required by its literal language, in fact, erases a key word, and furthermore injects ambiguity and uncertainty, all of which can and should be avoided by a narrower reading.

Under the EDD's interpretation, Congress meant to apply the offset to any employment which results in pension eligibility or increase. If Congress intended that result, it could have stated so with fewer words and greater clarity. The EDD's interpretation thus lends a gloss of ambiguity that clouds the meaning of "employer" for no discernible reason.

More fundamentally, the EDD's interpretation renders the word "such" in subparagraph (A)(ii) superfluous. If the only criteria for applying the offset were that the base period employment result in pension eligibility or increase, (as the EDD's interpretation demands), there would be no need for the words "for such employer" to appear in (A)(ii). In order to instill meaning in that phrase and the remainder of (A)(ii) as well, "for such employer" must be understood to mean the same employer as the base period employer. Thus, subparagraph (A)(ii) is comprised of two separate components: (a) a requirement that the base period employer be the same employer as that with which the employee became pension eligible, and (b) a requirement that the base period employment result in pension eligibility or increase.[2] In other words, (A)(ii) requires both a match between pension and base period employer, and in addition, a change in pension status resulting from that last employment.

Congress was certainly aware of the existence of multi-employer pension plans, and could easily have provided for the broad reading of §3304(a)(15) adopted by the EDD if it intended to do so. In fact, it has chosen in analogous contexts in the Internal Revenue Code (§§415 and 401(a)(17)) to apply the statute on an employer-by-employer rather than on a plan-wide basis. Again,

---

[2] At the October 15, 1992 meeting, Ms. Lopez cited Rivera v. Becerra, 714 F.2d 887 (9th Cir. 1983), a social security case, as a possible analog in support of EDD's position. However, subparagraph (A)(ii) expressly does not apply at all to social security, and does apply to private pensions such as those covering SAG, AFTRA and WGA members. The Ninth Circuit recognized and articulated that distinction in its discussion of the legislative history, 714 F.2d at 893. Indeed, the Seventh Circuit Court of Appeals recognized that in the private pension context, the limitation of offset applicability to a return to work with the same employer would apply. Peare v. McFarland, 778 F.2d 354, 356-357 (7th Cir. 1985).

given the legislative admonition enunciated in §1255.3(b) and Evans, if there is any room for discretion in interpreting the federal law, the EDD must opt for the position that most severely confines the offset burden. The above discussion demonstrates that such a limiting construction is dictated by the statute.

In sum, the interpretation of the federal offset adopted by the EDD, rather than being required, is in fact not justified by its literal language. A more sound interpretation, and one in keeping with state policy, would apply the offset only where the same employer provided both the pension and the base period work resulting in pension eligibility or increase.

We hope the above persuades you to reconsider and revise the EDD's position consistent therewith. We request the opportunity to meet with you to further explicate our position and address any questions you may have, sometime in mid to late January. Please contact the undersigned so we may arrange for such a meeting. Thank you for your cooperation.

Very truly yours,

TAYLOR, ROTH, BUSH & GEFFNER
A Law Corporation

IRA L. GOTTLIEB

ILG:pjw

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Leonard Chassman
Vicki Shapiro
Bert Freed
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Pamm Fair
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EDD Serving the People of California

State of California / Health and Welfare Agency

Pete Wilson, Governor

May 4, 1993

REFER TO: 40:10:93.0241:arm
(916) 654-8210

Mr. John Humphrey
Regional Director
for Unemployment Insurance Services
Employment and Training Administration
U. S. Department of Labor
P. O. Box 193767
San Francisco, CA 94119-3767

Dear Mr. Humphrey:

In December 1992, we received a letter from the law firm which represents the Screen Actors Guild (SAG), the American Federation of Television and Radio Artists (AFTRA) and The Writers Guild of America, west (WGA, west), hereafter referred to as the "Unions." The letter requested that we reconsider our Department's position with respect to when a pension from a multi-employer pension plan is deductible from unemployment insurance (UI) benefits. Enclosed for your information is a copy of the letter dated December 22, 1992.

California law requiring the offset of pension benefits from UI benefits conforms with federal law, 26 U.S.C., Section 3304(a) (15). Based on our interpretation of both state and federal law, a pension which is based on an individual's own work is deductible from UI benefits if:

1. A base period employer on the UI claim maintained or contributed to the fund from which the pension is paid, and

2. The work performed by the individual after the beginning of the base period affected the individual's eligibility to receive the pension or increased the award of the pension.

The Unions agree with the Department that a pension received by one of their members would be deductible under the following circumstances:

An individual worked for 30 years for employer A and employer B, both of whom had contracts with SAG and so contributed to the pension fund provided for in the collective bargaining

agreement. The individual filed for UI benefits and both employer A and employer B were base period employers on the UI claim. The work performed by the individual after the beginning of the base period increased the individual's pension award.

The Unions and their attorneys urge that a pension received from a multi-employer pension plan should be deductible "only where the pension employer and the base period employer are the identical, single employer" as in the example shown above.

In those instances where the base period employer is not an employer for whom the individual worked while earning his or her initial entitlement to the pension, the Unions argue that the pension should not be deductible from the UI benefits. For example:

> The same individual mentioned above secured work with employer C some two years after applying for his SAG pension which was based on employment with employers A and B. Employer C also had a collective bargaining agreement with SAG and contributed to the pension fund on the individual's behalf while he worked. After being laid off by employer C, the individual filed a valid claim for UI benefits. The only base period employer was employer C.
>
> The Department determined that the work the individual performed for employer C after the beginning of the base period did result in an increase in the pension award. Thus, the entire pension (and not merely the increase) will be deductible from the UI benefits.

The Department's position is that employer C contributes to the same multi-employer pension fund from which the individual's pension is paid. Employer C is a base period employer and the work the individual performed after the beginning of the base period did result in an increase of the pension award.

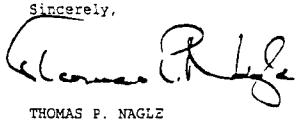
The Unions and their attorneys disagree with this interpretation. Their position is that the individual earned his initial eligibility for the SAG pension based on his work with employer A and employer B, neither of whom were base period employers in the second example. Thus, employer C is not the "pension" employer and the pension benefits should not be deducted from the UI benefits.

While the Department feels that its interpretation of state and federal law with respect to the offset of pension payments from UI benefits is correct, we agreed to request an opinion from the Department of Labor (DOL) as to whether there would be a conformity issue should our Department change its interpretation of how the pension offset law applies to pensions paid from a multi-employer pension fund and adopt the interpretation urged by the Unions.

We request an opinion as to whether the DOL would consider that the Department was exempting retirement income which meets the requirements of subparagraph (A) of Section 3304(a) (15) from deduction and whether this would result in a conformity issue.

Thank you for your assistance in this matter.

Sincerely,



THOMAS P. NAGLE
Director

Enclosure

cc: Screen Actors Guild
Ira L. Gottlieb

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Of Counsel:
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J. Weldon Granger*
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File No.:
11640-0041

VIA EXPRESS MAIL

May 17, 1993

Mr. John Humphrey
Regional Director for the
Unemployment Insurance Services
Employment and Training Administration
U.S. Department of Labor
Post Office Box 193767
San Francisco, California 94119-3767

RE: Unemployment Benefit Offset by Pension

Dear Mr. Humphrey:

This is to supplement the position taken by SAG, AFTRA and the WGA, west which was set forth in my December 22, 1992 letter to Thomas Nagle, and enclosed with Mr. Nagle's May 4, 1993 letter to you.

As you are aware, it is the policy of the State of California to maximize the availability of unemployment benefits to employees in this state, and concomitantly to encourage people to seek and obtain gainful employment. The current position of the EDD does not fulfill those goals to the greatest extent consistent with applicable law, and as will be explained in this letter, in fact inhibits the search for employment among retirees. We are confident that the EDD would reconsider its policy if the Department of Labor provides it with assurances that it will not be considered out of conformity with federal law in doing so. Since there is no federal law expressly prohibiting the adoption of the Unions' position in the multiemployer context, there is no reason for the DOL to intervene in this matter. The Unions therefore urge the Department to give the EDD approval to reconsider its policy on this point.

THE PROBLEM

As noted in our December 1992 letter, especially in the current economy, the Unions' retirees find it necessary to supplement their base retirement income with earnings from new employment. Retirees already encounter severe difficulties in this endeavor because of the tendency of employers not to hire older workers, the intermittent character of the work they perform, and generally because of the dismal economic conditions that currently prevail in California.

The difficulties faced by the retirees are compounded by the problem the Unions seek to address in this letter. The industry in which the Unions' members work is dominated by a multi-employer unit consisting of individual employers who contribute to a collectively-bargained pension plan. The EDD's treatment of the unit as one large employer for offset purposes is neither mandated by federal law, nor serves the legislative purpose of avoiding having an employer pay twice to benefit an unemployed retiree. Under the current EDD regime, if a retiree works for an employer who contributes to the multiemployer pension, and as a result of that work, her pension increases, then the entire amount of her pension (not just the amount of the increase) is applied to offset any claim for unemployment benefits. The EDD applies this rule even to base period employers who did not contribute to the original pension of the employee. The deterrent effect of this rule is clear: why perform intermittent work for relatively little income and a minute increase in pension, if that increase will erase the unemployment benefits needed to tide oneself over between jobs? At least where the pension employer and base period employer are not the same, there is no rule or reason to justify that result.

LEGISLATIVE HISTORY

Our December 1992 letter provides the textual analysis supporting the desired change in the EDD's policy. Enclosed with this letter are excerpts from the legislative history demonstrating that the amendments to the federal law relating to pension offset were designed to limit that offset to "only those unemployed workers who were collecting unemployment benefits and retirement payments from the same employer" (Tab A, p.23048 (highlighted portion)). Senator Bradley's remarks

included in the booklet are to the same effect: if an employee works for an employer who is "separate and apart" from the employer paying his pension, and is laid off, he is entitled to unemployment benefits (Tab B, pp. 26040-26041). There is no reason to expand the narrow legislative focus, trained on avoiding an employer "double" payment, in the context of multi-employer-dominated industries.

That Congress was aware of the existence of such industries and nevertheless chose not to broaden the scope of the pension offset as the EDD has done is evidenced by the portion of legislative history at Tab C. Congress was addressing changes in ERISA specifically with respect to multiemployer pension plans at the very time it was enacting the pension offset amendments that are found at 26 U.S.C. §3304(a)(15). Congress recognized certain advantages to the utilization of such plans, and found them "particularly but not exclusively important in industries such as . . . the performing arts, which (is) characterized by mobility of employees, or employers, or rapid turnover of both" (Tab C, p.2921). If Congress had wished to require expansion of the pension offset in the multiemployer context in the manner of the EDD's policy, given its consciousness of the prevalence of such plans in certain prominent industries, it would have done so. In the absence of such a clear federal requirement, the DOL need not impose one on the state of California.

CONCLUSION

In our telephone conversation last week, you mentioned that your initial response to the EDD's correspondence was to avoid intervention in the absence of a federal mandate contrary to any suggested EDD action. Acknowledging that that response was neither final nor the official DOL position at this time, the Unions urge the DOL to follow that initial impulse, and allow the EDD the latitude necessary to modify its policy in the manner advocated herein. That modification would be consistent with federal law and Congressional intent, and would effectuate California policy to the benefit of employees in this state.

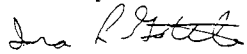
Once you have had an opportunity to consider this matter, we

would request a meeting with you to discuss the DOL's response and the steps to be taken thereafter.

Thank you for your consideration.

Very truly yours,

TAYLOR, ROTH, BUSH & GEFFNER
A Law Corporation



IRA L. GOTTLIEB

ILG:pjw

Enclosure(s)

cc: Ken Orsatti
Leonard Chassman
Vicki Shapiro
Bert Freed
Warren Kimmerling
Mark Farber
Pamm Fair
Brian Walton
Thomas Nagle (Director, EDD)

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afl-cio

U.S. Department of Labor

Employment and Training Administration
P.O. Box 193767
San Francisco, California 94119-3767

Reply to the Attention of: 9TGU

June 9, 1993

Mr. Thomas P. Nagle
Director
Employment Development Department
P.O. Box 826880 (Attn: MIC 40)
Sacramento, CA 94280-0001

Dear Mr. Nagle:

I am writing in reply to your May 4, 1993, request for an opinion on the issue of pension offset. In particular, you asked whether altering the Employment Development Department's interpretation of the pension offset provision as requested by attorneys for several entertainment industry unions, would raise an issue of conformity with Federal statute.

The law corporation of Taylor, Roth, Bush & Geffner, as representatives for the Screen Actors Guild, the American Federation of Television and Radio Artists and the Writers' Guild of America, hereafter referred to as the "unions", argue that by incorporating a broader than necessary interpretation of Federal pension offset provisions, California policy needlessly penalizes individuals in the entertainment industry who are covered under a multi-employer pension plan. States may, of course, choose to broaden the application of the offset provision beyond the minimum Federal requirement. However, a State may not consistently with Federal law exempt any pension income from offset if offset is required by application of the minimum Federal requirements. Although we are sympathetic to the difficulties faced by retirees, it is our opinion that adoption of the policy suggested by the unions and their attorneys would exempt from offset pensions which are subject to offset under the minimum Federal requirement.

The provisions of Federal law relevant to pension offset of unemployment insurance benefits are found at Section 3304 (a)(15)(A)(i & ii) of the Federal Unemployment Tax Act (FUTA) which states:

> "(15) the amount of compensation payable to an individual . . . which begins in a period with respect to which such individual is receiving a governmental or other pension, retirement pay, annuity, or any other similar periodic payment which is based on the previous work of such individual shall be reduced (but not below zero) *by an amount equal to the amount of such pension*, retirement or retired pay, annuity or other payment which is reasonably attributable to such week except that -

> (A)the requirements of this paragraph shall apply to any pension, retirement or retired pay, annuity, or other similar periodic payment only if-
>
> (i) such pension, retirement or retired pay, annuity, or similar payment is under a plan maintained *(or contributed to)* by a base period employer or chargeable employer . . . , and
>
> (ii) in the case of such a payment not made under the Social Security Act or the Railroad Retirement Act of 1974 . . . services performed for such employer by the individual after the beginning of the base period . . . affect eligibility for, or increase the amount of, such retirement or retired pay, annuity or other similar periodic payment, and' [Emphasis added.]

In letters dated December 22, 1992, (to T. Nagle) and May 17, 1993, (to J. Humphrey), Ira Gottlieb, a member of the law corporation representing the unions, has proposed that pension offset is only required when the base period employer is the same employer as that with which the employee became pension eligible and that such base period employment resulted in pension eligibility or a pension increase. Mr. Gottlieb further argues that each employer member of a multi-employer unit should be considered as a separate and distinct employer. The following example illustrates the issue.

> An individual works for employer A and employer B, for 20 years, both of whom are members of a multi-employer unit and contributed to the same pension plan. The individual establishes pension eligibility based on employment with A and B.
>
> Some years later, while drawing the pension based on employment with A and B, the same individual secures work with employer C, a member of and contributor to the same multi-employer unit/pension plan to which A and B belong. After being laid off by employer C, the sole base period employer, the individual files a valid claim for unemployment insurance benefits. Contributions by employer C to the pension plan for services performed after the beginning of the base period result in an increase in the individual's pension. Consequently, the entire pension is deducted from the individual's UI benefits.

Mr. Gottlieb contends that because the individual's initial pension eligibility was established by employment with employers A and B, neither of whom are base period employers, UI benefits following separation from employer C are not subject to any offset.

Plaintiffs in several circuit court cases[1] have raised the same argument unsuccessfully and like Mr. Gottlieb, have cited the legislative history to support their argument.

The case Rivera v. Becerra(9th Circuit 1983), discusses in detail the meaning of the 3304(a)(15)(A)(i), and the appropriateness of reverting to legislative history to determine that meaning. On the issue of reverting to legislative history, the court ruled that the meaning of the statute is clear on the face and hence resort to the legislative history is not necessary. The court did not agree with the plaintiff's argument that pension offset was only required when the pension eligible employer and the base period employer are one and the same. Although the pension plan in question in Rivera was a Social Security pension, the court's determination was based on its interpretation of 3304(a)(15)(A)(i), which is applicable to both private and government pensions. The offset applies under section 3304(a)(15)(A)(i) if the base period employer "contributed" to the plan from which the pension benefits are derived. Section 3304(a)(15)(A)(ii) makes a further stipulation for offset of private pension plans that services performed "for such employer by the individual after the beginning of the base period . . . affect eligibility for, or increase the amount of such pension." This requirement is applied equally to both single employer units and multi-employer units.

Clearly in the above example, employer C is a base period employer who had contributed to the plan from which pension benefits are derived and services for such employer (employer C), have resulted in an increase in the pension amount. The 1980 amendments to the federal offset provisions lowered the minimum requirement to require offset for "only those unemployed workers who were collecting unemployment benefits and retirement payments from the same employer." In the above example, offset is required to preclude the individual from drawing UI benefits and the pension (amount of the increase) from employer C. Conversely, if the services performed for employer C did not affect the individual's eligibility for or cause an increase in the amount of the pension, no offset of UI benefits would be required under FUTA.

Offset of only the amount of pension increase based on employment with employer C would appear to be a more equitable alternative to offset of the total amount of the pension. However, as ruled in the Ninth Circuit, by which this office and EDD is bound, the language of the statute does not permit proportional offset. When the conditions of 3304(a)(15)(A)(i & ii) are satisfied the amount of compensation payable to an individual shall be reduced (but not below zero) by an amount equal to the amount of the pension.

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[1] Rivera v. Becerra, (9th Circuit 1983); Peare v. McFarland, (7th Circuit 1984); and Walker v. Donovan, (Eastern District Michigan, Southern Division, 1986)

In summary, it is our opinion that amending EDD policy to discontinue pension offset when the pension amount has been increased based on services performed in the base period, and the base period employer has contributed to a multi-employer pension plan, would raise an issue of conformity with the minimum requirements of Section 3304(a)(15), FUTA.

Questions concerning this information should be referred to Jamie Bachinski at (415) 744-6648.

Sincerely,

Don A. Balcar
Regional Administrator

cc: Ira Gottlieb, TAYLOR, ROTH, BUSH & GEFFNER, A law Corporation

Chairman SHAW. Thank you, Mr. Heston.

Mr. Rangel.

Mr. RANGEL. Thank you.

I want to thank Mr. Heston for taking the time out to testify because we are all aware that so few people who enter your business end up as successful as you have been, and therefore, we need people like you to encourage our young people to know that there is some type of a safety net for them.

I cannot think of anyone that would object to correcting this inequity as it exists, and I cannot think, Mr. Heston, of a piece of legislation that has hit this particular Subcommittee that has been bipartisan in nature, and so I want to welcome that opportunity. Then, if you have some spare time, a few Democratic things I may ask you to join with me on——

Mr. HESTON. That is a fair accomplishment.

Mr. RANGEL [continuing]. In helping some of these young people——

Mr. HESTON. I play many roles.

Mr. RANGEL. Welcome, and it really says a lot for you, knowing the value of your time to actually, as you would play the role, to take care of the lesser among your people.

Mr. HESTON. Well, thank you, Congressman.

If I may add a short addenda, I think an unusual, indeed, possibly unique feature of this problem is the small number of people to which it applies. You are talking about some 700 members of the various guilds I mentioned who would find themselves in this situation, and also to have their pension, as I said, not just reduced by the increase, but the entire pension, it seems clearly indefensible, as the Department of Labor actually agreed, but they said you are going to need legislation.

Thanks to you gentlemen here, we are——

Mr. RANGEL. Mr. Chairman, I understand—well, I know that some pension legislation may be coming to conference, and if it is within the scope, the leadership will make the decision, but I am certain on the outside there would be no objection.

Chairman SHAW. We are looking into that. I think there is a hook in the bill that presently is between the House and the Senate, and we possibly can work something out.

We are also going to have to formulate some legislation to take care of the Illinois situation, which is going to be a little more difficult because I think the administration filed a brief in support of Illinois and since has done a turnaround on it.

Mr. RANGEL. It may be a little more difficult for other reasons as well.

Chairman SHAW. I would like to thank the entire panel for their testimony. It is very insightful testimony. I feel that Mr. Farr and Mr. Upton have really thrown us a softball which we might be able to correct in a suspension. We will look into it.

Has anyone filed this bill on the other side?

Mr. UPTON. I would just note, Mr. Chairman, that both Mr. Farr and myself appeared before the Bipartisan Corrections Day Panel, and they recommended that we move forward and, obviously, go through the appropriate procedure here. Of course, the way that that system works is it does have to be reported out of Committee,

but I think they will look very favorably on not only putting that under suspension, but under a corrections day.

Chairman SHAW. Unless there are some fishhooks that aren't apparent, I can tell you that we will move that very expeditiously, but I think with elections coming up, maybe we can do something before that happens.

Mr. HESTON. And if I may?

Chairman SHAW. Yes, sir.

Mr. HESTON. In terms of our undertaking, we received assurances from Senator Hatch, in the other House——

Chairman SHAW. Yes, sir.

Mr. HESTON [continuing]. That he would be willing to cosponsor from that side, the lower body. I don't know how to put that, the lower body. I didn't say "upper." I said "other."

Chairman SHAW. If you will carry that message over to the Senate you can count on my full cooperation.

I thank all of you, and this hearing is adjourned.

[Whereupon, at 12:37 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

#96-18

STATEMENT OF THE
AMERICAN FEDERATION OF LABOR-
CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL-CIO)

FOR THE

SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES
July 11, 1996

The AFL-CIO encourages Congress to fashion a consensus response to unemployment insurance (UI) administrative financing problems. It is our belief that a solution can be reached which brings together labor, employers, federal and state administrators without fundamentally altering the current federal/state relationships. The current devolution proposals, however, can never build that consensus. If anything, by proposing a sweeping overhaul which threatens many ancillary elements of the core system and creates unnecessary uncertainties, these ill-conceived proposals delay the formation of the alliances we need to fix administrative problems.

Regarding the *Pennington* lawsuit, the AFL-CIO believes the right of claimants to a fair and accurate accounting of previous earnings and to payment of benefits in an expeditious manner must be weighed along with state rights to determine program characteristics. The State of Illinois has appealed this decision and has yet to exhaust its legal recourse. We believe the district court -- which is entirely composed of judges appointed by President Reagan -- has rendered a fair and accurate judgement which should not be overturned through legislative action.

The following statement addresses devolution and Pennington in that order.

DEVOLUTION

Pressing Issues Beyond Administrative Finance

The AFL-CIO shares the concerns of all panelists that administrative financing issues must be resolved. Our membership includes both claimants and public sector employees, creating a significant interest in a stable, fully-funded administrative system. However, we urge Congress to take a broader look at the unsatisfactory insurance afforded the nation's unemployed workers through the current federal/state system.

Throughout the 1980s, state and federal legal restrictions on eligibility have reduced the percentage of the unemployed receiving benefits from 75 percent in 1975 to only 36 percent last year. Even accounting for changes in the demographics of the unemployed, the Advisory Council on Unemployment Compensation and numerous independent researchers have noted the important contribution of state legal restrictions in reducing the

percentage of the unemployed who receive benefits.[1]

As the economy produces more low wage jobs and less secure employment, these tightening restrictions threaten the counter-cyclical power of the system and drastically curtail the insurance function of the program. At a time when millions of Americans feel vulnerable and anxious about their economic future, Congressional attention to peripheral notions like devolution is a distressing commentary on the state of political discourse around unemployment insurance. Worse, the Congressional attempt to circumvent the *Pennington* decision, as discussed below, threatens to undermine one positive step toward claimants' rights in the current environment.

What is Devolution?

The idea of "devolution", or sending administrative funding decisions to state jurisdictions, raises fundamental issues that extend far beyond what may at first appear to be a simple technical issue. In a wide range of policies where states are under increasing fiscal pressure -- from training to Medicaid to welfare -- reformers are pressing forward with efforts to expand state-level control over social policy. Devolution of UI administrative funding and policy is part of this broad wave of policy interventions. Indeed, because UI is already so heavily state oriented, we believe the current interest in devolution is merely an attempt to capitalize on a broad policy thrust where smaller administrative simplifications would achieve the same goal.

Plans for UI devolution have been advanced primarily by state administrators in Georgia, New Hampshire, Ohio, and Virginia. Although details vary, the thrust of these proposals is that states should collect and control administrative funds. The implication is that the federal government has too much control of "their" funds and leaves the states perpetually under funded. The proposals try to free additional administrative dollars by diverting program dollars, usually including elimination of the Extended Benefits program. Proposals vary in relation to other federal UI programs, labor market information, and other aspects of UI administration.

Devolution: History

"Devolution" is an idea which comes and goes. It periodically resurfaces and it never happens. In Ways and Means hearings in 1939, the Social Security Board noted

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[1] Bassi, et al. (1996) "The Evolution of Unemployment Insurance," Advisory Council on Unemployment Compensation, Background Papers, Volume III, January; Anderson and Meyer (1994) "Unemployment Insurance Benefits and Takeup Rates," Working Paper 4787, National Bureau of Economic Research; Corson and Nicholson (1988) "An Examination of Declining UI Claims During the 1980s," UI Occasional Paper 88-3, US Department of Labor.

> the suggestion...the Federal Government should collect the entire Federal tax and make grants-in-aid to the States, instead of allowing an offset on the Federal tax.

Since 1939 the boundaries between federal and state activity have been fought over again and again without a significant move toward devolution. No constituency is completely satisfied with the existing mix of roles -- least of all those of us who advocate for claimants -- but no constituency can gain enough allies to change the balance. Devolution is particularly vulnerable in this regard, because its strong allies are comparatively few given the potential impact on the system.

It is difficult to find any sizeable block of support for devolution. Most large, multistate employers don't like the uncertainty that the new proposal introduces. They are not swayed by the illusory promise of easier wage reporting. The fact is, they don't know what systems they will face in 50 unique state tax environments. Even more employers worry about UI funds mingling with other state funds, a practice currently restricted by federal law.[2] Claimant advocates know that a range of programs will be eliminated and they are uncertain about state commitments in the face of interstate competition. Small states worry about funding adequacy.

Advocates of devolution may think they have solutions for each of these criticisms, but a vast reform like they are proposing needs staunch allies and clear benefits. These proposals are unlikely ever to achieve that broad level of confidence.

Is the Current Fund Distribution Unfair?

Devolution proponents argue that the current system should be eliminated in part because of the supposedly unfair distribution of funds both among the states and between the federal government and all states. They point out that only two-thirds of all UI tax dollars are returned to the states. They also point to the high rate of return of tax dollars to some states and low percentage return in others. This perspective obviously disregards the fact that any insurance system will redistribute pooled funds based on differences in risk. It is not sufficient to say that some states get back less than they send to Washington. Reform advocates must show that they get back less than they need to fulfill their obligations to the unemployed. A review of performance in the states which are pushing devolution provides some insight into the source of their low return on funding.

All four of the states which have advocated devolution had a

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[2] These and other employer concerns are well-documented in Employers Unemployment Compensation Council (Michigan) "Discussion Paper on Devolution", January 18, 1996.

lower percentage of the unemployed receiving benefits than the national average; three of the four paid benefits to less than one-fourth of their unemployed. Similarly, the biggest winner in the transfer of administrative funding was Alaska, a state which also leads the nation in percentage of the unemployed receiving benefits. New Hampshire, which pays only one-fourth of its unemployed benefits, gets only about 60 percent of its FUTA payments returned in grants. This suggests that, far from being an issue of inequity, the uneven transfer of funds among states reflects the fact that the unemployed are more likely to receive benefits in some states than in others. New Hampshire, Virginia, Georgia, and Indiana would have higher reimbursement rates if their systems met the needs of more of the unemployed in their states.

National Priorities Still Relevant

In 1935, various program designs were debated for the UI system. Given the rapid expansion of federal authority in the New Deal, the proposal for UI was based on a strategic decision not to push for a national system. Instead, the Social Security Act imposed a federal tax which would be refunded, in part, to states that established UI systems in conformance with a narrow set of federal standards relating to administrative requirements and coverage of selected industries. The federal tax was primarily used to encourage state activity, not to fund a federal program. This approach left eligibility, benefit duration, and benefit levels in state control.

There is another, equally important fact about the use of a federal UI tax to leverage state action. It was quite consciously intended to reduce the role that interstate competition played in thwarting state efforts to establish UI systems. A uniform taxable wage base and tax rate were seen as a level playing field from which states would build their systems. This uniform, national tax for administration was quite consciously part of the federal element of the system.

The current push to expand state control reduces federal input into a system that is already dominated by state interests. States currently control decisions about who receives benefits, how long they will receive benefits, how much they will receive, whether the state will adopt alternate triggers for Extended Benefits, and what level of experience rating their taxes will reflect. Although states might prefer to have complete control over every aspect of the system, we believe the modest authority which remains in federal hands through administrative financing plays an important, if small, role in maintaining system integrity. Nationally important recent initiatives around quality control, demonstrations, and research are particularly threatened.

FUTA Funds Diverted from Employment Service Programs

If there is any consensus among employers and the labor movement regarding UI it is that FUTA funds should only be used

for unemployment-related purposes. Employers and labor have been willing to make a few noteworthy exceptions to this rule by diverting some UI funds into training accounts in a small number of states. These programs are good examples of exceptions that prove the rule; they reflect intense bargaining among interests and include significant program oversight by joint labor-management bodies. They are extremely controversial, and both labor and employers tend to rally around the concept of keeping the UI trust funds as a trust for the unemployed.

There is widespread concern that devolving administrative funds to the states will promote a merger of employment-related funds with other funds. In the process, the interests and concerns that labor and business share will be more difficult to realize. This concern is particularly acute given current proposals to block grant many other social programs and the downward pressure on federal funding.

There is another troubling aspect to this merging of funds. Again, the origins of UI financing are instructive in this regard. As early as 1939, the Social Security Board voiced concern about state control leading to political patronage. The Social Security Act established federal oversight and merit employment systems precisely to avoid expanding patronage and making the system vulnerable to corruption. The rush to devolve UI administration and every other social policy reopens this critical debate in American politics. We are deeply concerned that devolution of administrative funds will result in a new breed of patronage as private firms and political friends vie for these funds without sufficient federal oversight or merit employment requirements.

Threat to Insurance Functions

Secure administrative financing is essential to fulfilling the insurance function of UI. Devolution poses a potential threat to social insurance in two senses. First, the essence of social insurance is pooled risk. A devolved administrative financing system narrows the pool of available funds for administrative uncertainties. Economic downturns are never evenly distributed across the states. The risks facing administrative funding should be more broadly distributed to acknowledge this.

Second, downward pressure on administrative funding implies downward pressure on program performance. For example, the cost of administering a benefits denial is almost certainly lower than the cost of administering a successful claim for benefits. Any administrative financing system should acknowledge the higher cost associated with case management versus disqualifications. We are concerned that downward pressure on administrative funding will lead to unfair restrictions on access to the system. Similarly, small states and less populous state will almost certainly have to raise employer taxes following devolution. All of the states that had a 90 percent or better return of FUTA funds in grants had small tax bases: Alaska, Idaho, Maine, Montana, North Dakota, Rhode Island, Vermont, Wyoming.

Loan Fund an Important Current Feature

A specific insurance feature of the current system which must be retained is the loan fund. Under current law, a portion of FUTA taxes goes into a Federal Unemployment Account (FUA) which makes loans to insolvent state trust funds. States currently repay these loans with interest. This fund is a vital part of the national commitment to social insurance. Any devolution proposal which threatens its integrity should be rejected.

Extended Benefits Program Issues

Most proposal for devolution include elimination of the Extended Benefits program. Such proposals go far beyond the supposed technical fix that advocates claim they are making through devolution.

The AFL-CIO has long been a critic of the existing EB program, but we believe the program should be improved and not eliminated. It is noteworthy that the Advisory Council on Unemployment Compensation devoted all of its 1994 recommendations to this program. We concur with their recommendations in this area, particularly the use of the state's seasonally adjusted total unemployment rate as an EB trigger mechanism. Since 1.3 million unemployed workers were without work for 27 weeks or more last year, proposals to eliminate the EB program, rather than strengthen it, should be rejected.

Administrative Funding Reform Possible Without Devolution

We agree that some aspects of the current administrative funding structure should be reformed. It is possible to shape a reform agenda that brings together labor, employers, and administrators around common concerns. An acceptable reform proposal must promote a better linkage between work load and available funding. We believe this can be achieved within the existing Department of Labor effort around the Administrative Financing Initiative. Any reform must encourage innovation and research in the national interest as well as cover current expenditures. It should provide a secure funding base for unexpected economic downturns. It should address unnecessary restrictions on the movement of funds within the Employment Service, though not out of the Employment Service. It should promote simplification of employer paperwork without sacrificing important labor market information.

PENNINGTON VS ILLINOIS

Unemployment Insurance and the Low Wage Labor Market

As mentioned at the outset, the AFL-CIO is particularly concerned that restrictions in state UI programs prevent too many of the unemployed from receiving benefits. Within the range of

barriers put in place by state programs, monetary eligibility requirements disproportionately affect low wage workers. The reduced purchasing power of displaced, low income workers is a significant public policy issue which warrants national attention.

Research funded by the non-partisan National Commission for Employment Policy last year examined the impact of state monetary eligibility requirements on UI recipiency rates for various population groups.[3] Their research essentially duplicated the eligibility screening process which unemployed individuals face in each UI jurisdiction. They used the earnings history of individuals in the Survey of Income and Program Participation to estimate the number of individuals rendered ineligible for UI at each step in eligibility determination.

Among their findings were: (1) 34 percent of women and 15 percent of men were excluded from benefits due to monetary eligibility issues, (2) women are twice as likely as men to fail state requirements for high quarter earnings, and (3) only nine percent of all unemployed workers who worked part-time received benefits. These findings suggest that state monetary eligibility requirements, particularly for high quarter earnings, pose a significant hurdle for the unemployed seeking insurance benefits. The impact of high quarter requirements is exacerbated where states delay counting the most recent quarter of earnings, a quarter which may prove essential to eligibility. The Pennington case thus represents a small step toward rectifying the vast disparity of treatment which the unemployed face under current state practice in most states.

The *Pennington* Case

In *Luella Pennington vs Lynn Doherty, Director of the Illinois Department of Employment Security*, 22F.3rd 1376 (7th Cir. 1994) the Seventh Circuit court found that federal timeliness requirements (the so-called "when due" clause) of the Social Security Act were violated because Illinois makes eligible workers wait up to six months before they file a claim in order to allow time for processing the most recent quarter of earnings at the time of layoff. The U.S. Supreme Court denied the Illinois appeal. On remand, the U.S. District Court ordered Illinois "to adopt an alternative within a reasonable time" to expedite accounting for a worker's most recent earnings. The state is not currently paying anyone benefits under the required change. Illinois has filed an appeal.

Claimants' Rights and States' Rights

Pennington simply requires a state to include the most recent earnings in calculating benefit eligibility. Illinois

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[3] Yoon, Spalter-Roth, Baldwin (1995), "Unemployment Insurance: Barriers to Access for Women and Part-Time Workers," National Commission for Employment Policy.

suggests that the state right to set eligibility is paramount, claiming 60 years of history. Over those same 60 years, however, the federal government has had the right to insist that benefits be paid in a timely manner (under the "when due" clause) and has exercised that right. In *Pennington*, the Republican-appointed US Court of Appeals, Seventh Circuit, ruled that waiting up to six months for reported wages was a violation of timeliness and they ruled that it was administratively feasible to count most recent earnings. Illinois can and should accurately count earnings. They should not come to Congress to deny this responsibility.

Eight States Have Voluntarily Passed Moveable Base Legislation

Eight state have voluntarily passed legislation to do what Illinois claims it cannot accomplish. In Maine, Massachusetts, New Jersey, Ohio, Rhode Island, Vermont, and Washington, states use a base period which includes earnings in the most recent quarter. Michigan has adopted a flexible base period effective one year from now. With so many states successfully adopting a moveable base period, it is not surprising that Illinois has thus far been unable to convince the court that it is not administratively feasible. We urge Congress to avoid passing legislation which will impede claimants' rights to what has been repeatedly proven feasible.

Avoiding Welfare Through Fair Accounting

Opponents of *Pennington* claim that it makes UI more like welfare. Apparently, they believe any effort to include more of the unemployed in the program will necessarily involve including the "undeserving". They couldn't be more wrong. We believe the opposite is true. *Pennington* requires Illinois to make a timely, accurate accounting a worker's employment history. By more accurately measuring labor force attachment, *Pennington* requires Illinois to pay UI to unemployed **workers**. Ironically, without this administrative fix, many unemployed workers will be denied benefits and be more likely to receive welfare instead.

The U.S. labor market is increasingly producing low wage, contingent jobs. Yet state eligibility criteria continue to reflect past history, demanding high prior earnings and stable employment. We believe significant change is needed to bring state UI systems in line with existing labor market trends. Only by adopting reforms such as the moveable base period can UI eligibility criteria accurately reflect an individual's attachment to the new labor market.

CLOSING REMARKS

The U.S. unemployment insurance system is in dire need of reform. Too few of the unemployed receive too little in benefits for too short a time. In addition, the current administrative financing system keeps the supporting infrastructure of the system starved for funds. This situation is problematic enough given the current, lengthy economic recovery. But this recovery

will not last forever. We are deeply concerned that the next economic downturn will be confronted with insufficient administrative funds and a state-based system that is far too restrictive to provide the necessary counter-cyclical demand. We see an overwhelming need to return the system to its founding principles -- an insurance system help the unemployed weather economic misfortune, a national commitment to smoothing the crashing waves of economic uncertainty.

GOVERNOR PETE WILSON

Statement of the Honorable
PETE WILSON
Governor, State of California

before the
House Ways and Means Committee
Subcommittee on Human Resources

July 11, 1996

Mr. Chairman and Members of the Subcommittee, as you consider selected unemployment insurance issues I would like to bring to your attention a situation that has arisen in California involving the payment of unemployment benefits to criminals upon release from prison. Immediate action is required by Congress to prevent the blatant misuse of taxpayer dollars.

Pursuant to the passage of a ballot initiative by California voters in 1990, the State of California established the Joint Venture Program in the state prison system. Under this program, private businesses may contract with the California Department of Corrections to hire inmates to produce, on the grounds of state prisons, various goods and services for sale. Similar programs have also been established in several other states.

The Joint Venture Program provides an opportunity for inmates to learn important work skills and generates revenues and savings to the state and federal governments. Up to eighty percent of an inmate's income is subject to: federal, state and local taxes; withholding for support of the prisoner's family; payment of restitution to crime victims; and reimbursement to the state for the cost of room and board.

The Joint Venture Program has been very successful. However, this partnership with the private sector has created an unintended consequence. Employers participating in the Joint Venture Program must pay unemployment insurance taxes for the inmates they employ through the program. This makes the inmate eligible for unemployment payments when they are paroled or released from prison. I am sure you would agree that the unemployment insurance program was never intended to be an ex-convict support program.

In an attempt to resolve this issue, the California Legislature passed and I signed a bill, S.B. 103, to place on the ballot an initiative to deny unemployment benefits to inmates upon their release from prison. The ballot initiative, Proposition 194, was overwhelmingly passed by California voters in March 1996.

This should have been the end of the story, but, unfortunately, it was not.

The U.S. Department of Labor has threatened to deny California companies $1.7 billion in unemployment insurance tax credits if the State of California implements Proposition 194. One option offered by the U.S. Department of Labor to avoid this action is for the State of California to make the inmates employees of the State. Not only is this option an insult to the hardworking California correctional staff, it is unacceptable to California taxpayers.

To prevent U.S. Department of Labor sanctions and ensure that criminals do not qualify for unemployment benefits upon release from prison, I support legislation introduced by

Congressman Bill Thomas, H.R. 3858. This bill would exempt services performed by inmates who participate in the Joint Venture Program and similar programs in other states from unemployment taxes.

Inmates who work in the prison laundry or kitchen or cabinet shop are already exempt from unemployment taxes under current law. Congressman Thomas' bill would merely extend that exemption to inmates who work in these relatively new private sector arrangements.

California voters have already issued a clear statement that they do not want their tax dollars used to pay unemployment benefits to inmates released from prison. I urge the subcommittee to act quickly to resolve this issue by passing Congressman Thomas' bill when it considers unemployment insurance reforms.

EMPLOYERS' UNEMPLOYMENT COMPENSATION COUNCIL
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DISCUSSION PAPER ON DEVOLUTION

BACKGROUND

All states enacted Unemployment Insurance (UI) laws in the mid-1930's as a result of a Congressional mandate passed in the Social Security Act. Over the years, this federal-state program has contributed to economic stability in the country by paying benefits to unemployed workers. For more than 60 years, this federal-state partnership has been amended and refined and, generally, has worked well.

Since its inception, the cost of administrating state Employment Security (ES) programs has been funded by an employer paid federal payroll tax. This Federal Unemployment Tax Act (FUTA) tax is collected by the IRS and deposited in the U.S. Treasury. The money is allocated to three separate federal ES accounts. As of the end of fiscal year 1995, the three accounts contained the following amounts:

	$ Billions
Employment Security Administration Account (ESAA)	2.40
Extended Unemployment Compensation Account (EUCA)	2.22
Federal Unemployment Account (FUA)	7.42
Total	12.04

ESAA pays for the administrative costs of running state ES programs. The allocation of administrative funding to the states is the responsibility of the U.S. Department of Labor (USDOL). EUCA pays for the 50% federal share of the Extended Unemployment Benefit Program. FUA is the account from which states can borrow funds to pay unemployment benefits if their state trust fund becomes insolvent.

The FUTA tax does not pay for the cost of state unemployment benefits to unemployed workers. These costs are funded by employer paid experience rated state taxes. The proceeds of the state taxes are also forwarded to the federal treasury and drawn down by each state, as needed, to pay benefits to unemployed workers.

FUTA requires employers to pay a gross federal payroll tax of 6.0% on the first $7,000 of wages paid annually to each employee. If the state unemployment insurance law conforms with federal requirements, employers are eligible for a tax credit of 5.4%, or 90% of the FUTA tax. Currently, employers in all states receive the tax credit. Since 1976, employers have paid an additional 0.2% temporary FUTA surtax. This surtax is now scheduled to expire on January 1, 1999 after having been extended several times by the Congress. Consequently, the net FUTA tax is 0.8%, or a maximum of $56 per employee.

There are four (4) proposals[1] to move the responsibility for the cost of administering state ES agencies from the federal government to the states. The concept, known as "Devolution", has been discussed and debated in past years, but appears to be gaining momentum and support. Devolution seems consistent with other federal initiatives to move the responsibility of programs from the federal government to the states. The impetus to devolve the responsibility for ES administrative costs to the states appears to be the result of several concerns, including the following:

[1] Specific proposals are from the states of Georgia, New Hampshire, Ohio and Virginia.

- Many ES administrators feel that allocations to state ES agencies by the USDOL are not sufficient to cover the administrative costs. A number of states have had to enact additional employer paid state taxes to cover the shortfall. State ES administrators argue that the formula, used by the USDOL to fund the states, is outmoded.

- ES administrators feel that administrative fund allocations for some ES programs have onerous reporting requirements and are inflexible as to the use of the funds. That is, the states are not permitted to move funds as needed for efficient administration.

- State ES agencies do not receive all of the FUTA taxes paid by employers in their state. This is most evident in periods of low unemployment, as is currently the case.

DEVOLUTION PROPOSALS

The Devolution proposals generally transfer to the states the responsibility for collecting and controlling administrative funds. The proposals differ as to the handling of currently existing funds held in the three federal accounts. All of the proposals require revenue from these administrative taxes to be deposited in the U.S. Treasury.

EMPLOYER CONCERNS

Some employers support the Devolution concept. However, several concerns need to be addressed and may argue against the transfer of the responsibility to the states.

1) Presently, FUTA taxes are earmarked for ES programs only. Employers are concerned about the possibility of mixing state administrative ES revenue with funds for non-ES programs.

2) The taxable wage base in 39 states exceeds the $7000 FUTA wage base. Employers are concerned that the FUTA "net tax" of 0.8% (including the temporary FUTA surtax) will be applied by states to their currently existing state taxable wage base. This would greatly increase employer taxes.

3) Interstate claims and multi-state coordination of ES programs need to be maintained. There is a concern that the costs to maintain this coordination will still require a federal tax.

4) There needs to be a mechanism which allows states to borrow funds from the Federal Treasury if state UI benefit Trust Funds become insolvent. The FUTA Federal Unemployment Account is the loan fund from which states borrow.

5) The Devolution proposals eliminate the "insurance" aspects of the federal-state partnership.

6) Most of the Devolution proposals eliminate the Federal-State Extended Benefit (EB) Program and leave the existence of this program to the discretion of each state. The EB Program provides additional weekly benefits during periods of high unemployment and have been some help in stabilizing the state and national economy.

7) While Congress is returning the responsibility of a number of programs to the states, the federal-state UI program is a creation of the Congress, not one which had its roots in the states and was taken over by the federal government. The continued existence of an interstate UI system has national economic implications.

ANOTHER ALTERNATIVE

While devolution of ES administrative financing to the states is supported by some employers and ES administrators, another alternative should be considered.

The inadequate funding problem expressed by state administrators and employers is a valid concern. However, this concern can be addressed within the current system. The methodology for providing administrative funding to states needs to be refined and updated. Policy regarding the movement of funds from one ES program to another needs to be changed to permit more efficient use of administrative funds.

The federal partners have considerable expertise. Their guidance and oversight of state programs has allowed the development of a number of new initiatives (state demonstration projects) which have resulted in their expansion to other states. Funding for these demonstration projects would be lost if devolution occurred.

The current high level of funds in the FUTA accounts should be re-examined. There is more than sufficient funds available to sustain the needs for which specific ES funds were designed. The Congress should reduce FUTA taxes, including the elimination of the 0.2% FUTA temporary surtax.

Statement of the
National Employment Law Project
& the Employment Task Force to the
U.S. House of Representatives
Ways & Means Committee
Subcommittee on Human Resources

On behalf of the National Employment Law Project (NELP) and the Employment Task Force (ETF), we are testifying in opposition to the bill sponsored by Congressman Philip M. Crane (Congressional Record, dated July 11, 1996), to legislatively overrule the decision in *Pennington v. Didrickson*, 22 F.3d 1376 (7th Cir. 1994), *cert. denied*, 115 S.Ct. 613 (1994) (*Pennington I*). After a decision on the merits by the district court, the *Pennington* case is again before the U.S. Court of Appeals for the Seventh Circuit (*Pennington II*) as a result of an appeal filed by the defendant, Director of the Illinois Department of Employment Security.

NELP is a national advocacy organization and non-profit law firm that represents the interests of low-wage workers, the working poor and the unemployed. For over 25 years, NELP has been actively involved in federal and state policy advocacy and court challenges to expand access to the unemployment compensation system. With respect to state legislation specifically, NELP recently authored a report entitled, *Women, Low-Wage Workers and the Unemployment Compensation System: State Legislative Models for Change*, and has authored numerous published articles on the unemployment compensation program. NELP also provides extensive technical assistance, advice and training to promote access to the unemployment compensation system. The Employment Task Force (ETF) is a national network of over 250 advocates who have a special expertise in the unemployment compensation system representing low-wage and unemployed workers.

Based on our background in the operation of the unemployment program, and its daily impact on the unemployed, we oppose any legislation to legislatively overrule the *Pennington I* case for the following reasons:

- The *Pennington I* Decision Upholds 60 Years of Established Law Interpreting the Social Security Act to Prevent the Hardship Caused by Delayed Payment of Benefits

- The *Pennington* Legislation, if Enacted, Would Continue the Dramatic Decline in Workers' Access Unemployment Benefits

- Counting Most Recent Earnings When Necessary, as Provided by the Movable Base Period, Supports Low-Wage Workers, Construction Workers, and other Neglected Goups

- Eight States Have Enacted a Movable Base Period, Establishing the Feasibility of its Administration

- The Movable Base Period Has Broad Bi-Partisan Support in the States

- To Overrule the *Pennington* Case by Legislation, While the Appeal is Still Pending, Would Undermine the Judicial Process

The *Pennington I* Decision Upholds 60 Years
Established Law Interpreting the Social Security Act
to Prevent the Hardship Caused by Delayed Payment of Benefits

The federal requirement that states pay benefits in a timely fashion, as codified by the "when due" clause of the Social Security Act (42 U.S.C. section 503(a)(3)), is one of the very few restrictions imposed on the states in the operation of the federal-state unemployment system. The *Pennington I* decision correctly interprets this limited federal obligation on the states following a long line of cases and the evolving standard of what is "administratively feasible", consistent with the federal regulations interpreting the statute.

Under the Illinois law, workers who need their most recent wages to qualify for benefits must instead wait 3 to 6 months until those wages make their way into the state's computer system. As a result, when they first apply for benefits, they are told they have to reapply months later. This is precisely the kind of unreasonable delay that the "when due" clause was intended to prohibit, as the appeals court clearly held in *Pennington I*. Thus, *Pennington* simply requires a state to use the most recent earnings in calculating eligibility for benefits. Illinois has not lost its ability to set its own monetary eligibility standard. It has only lost its ability to make workers with earnings over that standard wait for weeks or months before they can recover their benefits.

Indeed, *Pennington I* is a natural extension of a long line of cases interpreting the "when due" clause, including the Supreme Court's decision in *California Human Resources Dept. v. Java*, 402 U.S. 121, 133 (1971). In *Java*, for example, the Court did not consider simply whether the law requires that unemployment benefits be processed in a timely fashion, and the defendant's would argue. As a result, the Court struck down the practice, a policy decision of the state of California, to withhold benefits while appeals filed by an employer were pending. Similarly, in *Pennington I*, the court found that the "when due" clause was intended to protect against the delay caused by a policy decision to withhold payment of benefits. Moreover, what is "administratively feasible", the standard of the regulation interpreting the "when due" clause, necessarily changes over time. Thus, given changes in technology allowing for more prompt processing of wage records submitted by employers, the requirements of the "when due" clause must evolve as well, as the district court concluded in the *Pennington* case.

Delaying receipt of benefits has significant consequences, especially for low-wage workers who are often forced to rely instead on public assistance. For example, a study done in New York of workers who exhausted their unemployment benefits found that 26 percent eventually ended up on public assistance. As described in the *Java* case, which reviewed the legislative history of the "when due" clause, "[p]aying compensation to an unemployed worker promptly after an initial determination of eligibility accomplishes the congressional purposes of avoiding resort to welfare and stabilizing consumer demands; delaying compensation until months have elapsed defeats these purposes." If the State chooses to, it remains free under the *Pennington I* decision to change basic eligibility requirements, by increasing the earnings levels or reducing benefit levels, but not by slowing payment of benefits simply because the individual's most recent earnings are not yet registered in the State's wage record system.

Finally, the argument advanced at the hearing on the proposed legislation, that the court in this case deviated "180 degrees" from 60 years of history interpreting the "when due" clause, is pure hyperbole. To the contrary, the appeals court panel that decided the *Pennington I* case was as judicially conservative as any panel that has ever been assembled to hear a case. Indeed, each of the three judges on the panel was appointed to the bench by President Reagan (the district court judge as well was a Reagan appointee). The appeals court thus painstakingly followed the letter and spirit of the 1935 Social Security Act in applying the "when due" clause to this case. It is worth noting as well that

the Advisory Council on Unemployment Compensation (ACUC), a bi-partisan commission chaired by President's Bush's appointee, Janet Norwood, also concluded that requiring the movable base period "is consistent with the legislative requirement that states ensure full payment of Unemployment Insurance when due."

The *Pennington* Legislation, if Enacted, Would Continue the Dramatic Decline in Workers' Access Unemployment Benefits

Before addressing the proposed *Pennington* legislation in further detail, it is important to focus on the major issues that plague the program, as recently documented by the Advisory Council on Unemployment Compensation, which was specifically charged with reevaluating the effectiveness of the program. Most important, the ACUC lamented the dramatic decline in the rates that unemployed workers have been able to access unemployment benefits due, in part, to increased limits on coverage in federal and state laws. The *Pennington* legislation, if enacted, would conspicuously ignore the recommendations of the ACUC, and continue the disturbing trend in federal and state law limiting access to the unemployment benefits.

In the 38 years from 1946 to 1984, the percentage of the unemployed receiving benefits dropped below 40 percent only once. In 1975, it reached a high of 76 percent. Since 1984, it has dropped consistently below 40 percent, averaging 33 percent between 1984 and 1989. In 1990, the year the recession began, it stood at only 37 percent, much lower than any previous recession year. In June 1996, the ratio of the unemployed versus those who receive unemployment benefits stood at 33 percent, with wide variations from state to state (ranging from a high of 65 percent in Rhode Island to a low of 17.6 percent in Virginia, according to 1995 data). This trend poses a serious risk to the two main functions of the program: 1) to replace worker earnings while they look for new work; and 2) to stimulate and support the economy during periods of high unemployment.

As documented by a recent report of the National Commission for Employment Policy, women, part-time workers, and low-wage workers are also disproportionately excluded from recovering benefits. For example, prior earnings requirements exclude 34 percent of women versus 15 percent of men who apply for benefits. Indeed, women now account for 46 percent of the labor force, 44 percent of the unemployed, but only 40 percent of unemployment compensation recipients. Almost four times as many part-time workers than full-time workers fail to meet the prior earnings requirements. Finally, state monetary eligibility requirements, based on earnings levels rather than hours worked, conspicuously discriminate against low-wage workers. For example, a full-year worker earning the minimum wage and working at least 10 hours per week will qualify for benefits in only 17 states. By contrast, a full-year worker earning $10 an hour and working 10 hours a week will qualify for benefits in 47 states.

As a result of these disturbing developments, Congress created a bipartisan commission in 1992, the Advisory Council on Unemployment Compensation (ACUC), charged with reevaluating the effectiveness of the unemployment system at the state and federal levels. Three years and three reports later, the verdict from the ACUC came in loud and clear -- the unemployment system is fundamentally flawed and in dire need of repair. Significantly, the ACUC concluded that low-wage, temporary and part-time workers, who are disproportionately women, were the hardest hit by the failures of the current system. Ironically, this also occurs at a time when the low-wage workforce has been growing and welfare reform is forcing more and more women workers with young children into the labor market.

Counting Most Recent Earnings When Necessary,
as Provided by the Movable Base Period, Supports
Low-Wage Workers, Construction Workers & Other Neglected Group

The "movable base period" (MBP), as exists in eight states, permits the use of earnings in more recent quarters, when necessary in those cases where the claimant has insufficient earnings using the first four of the last five calender quarters.

As documented in the Urban Institute report prepared for U.S. Department of Labor, the MBP benefits several growing segments of the workforce that have historically been conspicuously excluded from coverage, including low-wage, part-time workers, intermittent and seasonal workers. Building construction showed the most significant gains of any industry under the MBP, with a 35 percent increase in coverage over other industries in those states that operate a MBP. Specifically, in the states studied, 8.2 percent of all claimants received benefits as a result of the MBP, compared to 11.4 percent of claimants who worked in building construction. Nationally, the estimates are that the movable base period increases eligibility by 6 to 8 percent (payouts increase by 4 to 6 percent).

Citing the concern that low-wage workers and part-time workers with substantial labor force attachment are unfairly being denied unemployment benefits, the ACUC thus recommended unanimously that "[a]ll states should use a movable base period in cases in which its use would qualify an Unemployment Insurance claimant to meet the state's monetary eligibility requirements."

Eight States Have Enacted a Movable Base Period,
Establishing the Feasibility of its Administration

Since 1988, movable base period legislation has been enacted in eight states (Maine, Massachusetts, Michigan (as of July 1997), New Jersey, Ohio, Rhode Island, Washington, Vermont). This list includes four of the ten states with the highest level of claims activity (Michigan, New Jersey, Ohio, Washington), thus accounting for 20 percent of nation's unemployment claims. If these states can operate the ABP without causing a collapse in the system or an outcry in opposition, it is fair to say that the consequences of administration are not prohibitive.

As the ACUC noted in its recommendation that the states adopt the movable base period, "advances in technology have made it feasible for all states to use the [movable base period] . . . ." The Urban Institute report makes this point as well, citing numerous strategies to reduce the costs of administration, such as speeding up the processing of wage reports already submitted by employers rather than the far more expensive approach, upon which the Illinois overestimates are based, of issuing individual requests of employers of wage information. In addition, as the ACUC concluded, a large proportion of those who are determined eligible using a movable base period would become eligible eventually, thus the savings involved in not processing future claims must be considered. Finally, as the ACUC also found, some increased costs in administration of the unemployment claims are clearly offset by states costs involved in processing and payment of means-tested benefits, such as Aid to Families with Dependent Children (AFDC) and Food Stamps.

The Movable Base Period
Has Broad Bi-Partisan Support in the States

Contrary to the perception promoted by the Illinois defendants, the MBP has the support of Republicans and Democrats, including President's Bush chair to the Advisory Council on Unemployment Compensation, industry representatives on the commission, and the Governors of New Jersey and New York.

The ACUC, chaired by President Bush's appointee, recommended that the states adopt the movable base period in no uncertain terms. Most recently, New Jersey did so in late 1995. The legislation passed both houses of the New Jersey Legislature, which are Republican controlled (Assembly vote: 77-0; Senate vote: 31-7), and was signed by Governor Whitman with substantial support of workers in the construction trades and other industries. This legislative session, Governor Pataki introduced a bill adopting the MBP in New York, which passed the Republican-controlled Senate and awaits action by the Assembly. Indeed, of all the states that have adopted the MBP, the New Jersey and New York legislation is among the most beneficial to claimants, covering not only the wages earned in the most recent completed calendar quarter but also the wages earned in the quarter in which the claimant filed for benefits not yet completed.

To Overrule the *Pennington* Case by Legislation,
While the Appeal is Still Pending,
Would Undermine the Judicial Process

Finally, it is an affront to the judicial process, not to mention an inefficient use of the limited time and resources of the U.S. Congress, to consider legislation to overrule the *Pennington I* case while the appeal is still pending before the federal courts. It would clearly set a dangerous precedent for Congress to step in at this point in the proceedings and take away the plaintiffs fundamental right to their day in court to prove and defend the case on the law and the merits.

On July 10, the day before the hearing before the Ways and Means Committee, Subcommittee on Human Resources, the state of Illinois filed a 48-page brief before the U.S. Court of Appeals for the Seventh Circuit, arguing for reversal of the district court's decision enjoining the state's system. Indeed, the defendants go to great lengths in their appeal brief to argue that the appeal court should review the trial court's decision "de novo"; an independent review of the law and facts which, if decided in favor of the defendants, would essentially render the controversy moot. Moreover, it is worth noting that *Pennington* case is still the only federal court decision on this issue, explaining why the U.S. Supreme Court declined to review the first appeal. Accordingly, in the interests of the plaintiffs' right to judicial review in the case and sensitive balance between the role of the federal courts and Congress, the controversy is one that should first be resolved by the federal courts.

Exorcising the Devil from DEVOLUTION

Devolution Need Not Reduce Federal Oversight

Devolution, allowing the states (instead of the federal government) to tax employers to pay for the administration of their own state jobless benefit programs, has spurred some important concerns. Many, including the national Advisory Council on Unemployment Compensation, have voiced the opinion that without federal oversight some states might severely cut back on their unemployment compensation programs. While most of the devolution proposals call for less federal involvement, under devolution, there could be just as much federal control as now exists.

Currently, the Federal Unemployment Tax Act (FUTA) requires employers to annually pay a basic tax rate of 6.0% (plus a 0.2% surtax) on the first $7,000 of each employee's wages. However, if a state's unemployment program meets certain federal requirements, then the employers in that state are granted a 90% reduction in the basic rate. This brings the net FUTA tax down to 0.6% (plus the 0.2% surtax). By asserting control over whether the states qualify for the 90% offset credit, the federal government effectively maintains oversight of the state unemployment compensation programs. The federal government also controls the purse strings on the amount of administrative funding granted to the states (from annual FUTA tax collections). Under devolution, the states (instead of the federal government) would collect the administrative taxes.

Devolution would not require that the federal government be eliminated from the process. The 90% offset credit which currently exists on FUTA taxes would simply be increased to a 100% offset credit. This means that as long as states conform to federal requirements the entire FUTA tax would be offset. This would effectively end the FUTA tax for as long as states remain in conformity.

If states failed to conform to federal requirements, their employers would lose all, or part, of the offset credit. Employers in those states would then suddenly be faced with paying not only their states' new administrative taxes but up to an additional 6.0% FUTA tax on the first $7,000 of each worker's wages. (The 0.2% surtax would presumably end.) Faced with such massive tax ramifications, employers would have the same strong motivation to make their states conform as presently exists.

Some have voiced the concern that devolution could adversely impact the six jurisdictions (Alaska, Virgin Islands, North Dakota, Wyoming, Rhode Island and Montana) that now receive more back in federal subsidies than their employers pay in FUTA taxes. How would these states get enough funding to run their programs? Wouldn't their new state administrative taxes have to be increased beyond what their employers are currently paying in FUTA taxes? In order to address this problem, the devolution proposals allow these states to continue to receive subsidies for several years during which time these jurisdictions would, hopefully, learn to live within their own resources. However, even if it were necessary for the other jurisdictions to continue to support these states indefinitely, they would collectively need to set aside only a small pittance ($25.7 million) compared to the $2.2 billion they are currently being shortchanged on FUTA dollars by the Washington D.C. bureaucracy.

Another argument sometimes given in favor of retaining the current system is that the FUTA tax allows the federal government to set aside funds for borrowing by states when their jobless benefit programs go bankrupt.

This argument might have been valid when the states could obtain *interest free* loans; however, now they must pay interest just like any other borrower. In addition, the federal government has penalized some states through disallowing part of the FUTA offset credit when states are delinquent in repaying their federal loans. As a consequence, many states already go through private sources for funds.

Perhaps the biggest challenge to passing effective legislation to devolve the administrative cost of state unemployment programs to the states is finding other savings to compensate for the *perceived* loss of the FUTA surplus by the federal government. The Congressional Budget Office (CBO) will likely score devolution as a net loss of funding. In actuality, devolution will end up as a substantial savings for most jurisdictions. Because the responsibility for funding state administration would be *devolved* to the states and the states' unemployment trust funds would continue to be banked in Washington D.C., a more realistic scoring would be that devolution is *revenue neutral*.

Unfortunately, the current political climate, spawned by a substantial federal budget deficit, may favor allowing the federal government to continue overcharging employers for the administration of their state unemployment programs. The table on the following page shows a clear imbalance in the way FUTA funds are currently being dispersed. Most states have been conspicuously shortchanged by the federal government's uneven return of their employers' FUTA taxes. Many states have even been forced to add administrative taxes to their state unemployment tax rate schedules. Employers in these states are paying for program administration twice–first through the FUTA tax and then through a separate state administrative tax.

The states receive back an average of just over 60% of the money that the federal government collects through the FUTA tax. The rest of the money is retained in Washington D.C. where it helps to counteract the budget deficit. Because most state unemployment agencies are accustomed to working with much less than their employers have been paying in FUTA taxes, providing a 100% offset against the federal tax would allow most states to replace the FUTA tax with substantially lower state administrative taxes. ©

Larry C. Clark is Vice President of Information Management for *The Gibbens Co., Inc.*, a national employee-owned firm which specializes in unemployment claims management. Mr. Clark is a member of the Board of *the National Foundation for Unemployment Compensation & Workers' Compensation*. He is Vice President of the *Association of Unemployment Tax Organizations*. Prior to his twenty-four year employment duty with Gibbens Company, Mr. Clark worked as an eligibility adjudicator and trainer for the *California Department of Human Resources Development* (now the Employment Development Department).

GIBBENS COMPANY

How many of their employer's FUTA dollars do the states get back?

Jurisdiction	FUTA Grants	FUTA Taxes	Grants/ Taxes	RANK	Jurisdiction	FUTA Grants	FUTA Taxes	Grants/ Taxes	RANK
Alaska	$29.8	$11.3	263.5%*	1	New Hampshire	$14.7	$24.5	60.0%	28
Virgin Islands	$3.2	$1.8	177.8%	2	Delaware	$10.4	$17.5	59.4%	29
North Dakota	$13.8	$11.0	125.5%	3	Arkansas	$27.4	$46.9	58.4%	30
Wyoming	$10.8	$8.9	121.3%	4	Illinois	$153.7	$270.7	56.8%	31
Rhode Island	$21.9	$18.3	119.7%	5	Oklahoma	$31.5	$57.3	55.0%	32
Montana	$13.7	$13.5	101.5%	6	Nebraska	$19.0	$34.6	54.9%	33
Idaho	$20.7	$21.4	96.7%	7	Wisconsin	$64.9	$119.5	54.3%	34
Maine	$22.2	$23.1	96.1%	8	Missouri	$60.9	$116.9	52.1%	35
Vermont	$10.6	$11.7	90.6%	9	Colorado	$44.7	$86.0	52.0%	36
Connecticut	$65.8	$74.3	88.6%	10	Mississippi	$25.4	$48.9	51.9%	37
Puerto Rico	$28.8	$33.1	87.0%	11	Alabama	$41.5	$82.8	50.1%	38
Washington	$94.6	$111.3	85.0%	12	So. Carolina	$36.6	$73.4	49.9%	39
Dist. of Columbia	$15.7	$18.5	84.9%	13	Louisiana	$38.1	$78.1	48.8%	40
California	$539.2	$655.5	82.3%	14	Iowa	$28.7	$59.4	48.3%	41
South Dakota	$10.6	$13.9	76.3%	15	Minnesota	$52.9	$111.2	47.6%	42
Utah	$29.2	$38.6	75.6%	16	Kentucky	$34.9	$73.8	47.3%	43
Oregon	$48.7	$65.6	74.2%	17	Kansas	$25.5	$54.3	47.0%	44
Pennsylvania	$173.7	$245.7	70.7%	18	Arizona	$39.4	$85.9	45.9%	45
Hawaii	$18.1	$25.7	70.4%	19	Texas	$172.0	$381.7	45.1%	46
Michigan	$142.8	$204.2	69.9%	20	Georgia	$68.2	$160.2	42.6%	47
New York	$248.4	$355.3	69.9%	21	Ohio	$105.7	$249.0	42.4%	48
Maryland	$69.0	$99.1	69.6%	22	Virginia	$60.0	$142.6	42.1%	49
New Jersey	$117.0	$168.2	69.6%	23	Florida	$116.7	$290.7	40.1%	50
West Virginia	$19.9	$29.4	67.7%	24	No. Carolina	$63.6	$165.3	38.5%	51
New Mexico	$18.9	$28.0	67.5%	25	Tennessee	$43.8	$113.9	38.5%	52
Nevada	$25.2	$39.0	64.6%	26	Indiana	$48.5	$129.3	37.5%	53
Massachusetts	$87.8	$136.1	64.5%	27	TOTALS	$3,327.8	$5,538.6	60.1%	

Jurisdictions are ranked by percentage of FUTA taxes returned in the form of federal administrative grants. Dollars shown are in millions. Totals may not add up due to rounding. These are the latest figures available and apply to Federal FY '94. The source of this information is the U.S. Department of Labor. The six highlighted jurisdictions are the only ones which received more back from the federal government than they paid under the Federal Unemployment Tax Act (FUTA). As you can see from the totals, the federal government retained over $2,210,800,000. This is a compelling argument for devolving the expense of administration of unemployment insurance programs away from the federal government and giving it to the states.

STATEMENT OF JOHN DODDS, PAUL LODICO AND BARNEY OURSLER PHILADELPHIA UNEMPLOYMENT PROJECT MON VALLEY UNEMPLOYED COMMITTEE BEFORE THE COMMITTEE ON WAYS AND MEANS SUBCOMMITTEE ON HUMAN RESOURCES U.S. HOUSE OF REPRESENTATIVES ON THE SUBJECT OF UNEMPLOYMENT INSURANCE ISSUES

July 25, 1996

Mr. Chairperson and Members of the Subcommittee on Human Resources. We are John Dodds, Director of the Philadelphia Unemployment Project, from Philadelphia, Pennsylvania, and Barney Oursler and Paul Lodico, Directors of the Mon Valley Unemployed Committee, located in Western Pennsylvania. Both the Philadelphia Unemployment Project and Mon Valley Unemployed Committee are membership organizations which provide advice and assistance to large numbers of unemployed individuals in our respective communities. We also participate in advocacy efforts on behalf of the unemployed at the local, state, and national levels. We would like to thank the Committee for providing us with the opportunity to present to you our views as to why Congressional action would be inappropriate to reverse the 7th Circuit decision in Pennington v. Didrickson. That decision interpreted the "when due" requirement in the Social Security Act, which requires the payment of benefits as soon as "administratively feasible", to mandate the use of a base period counting recent wages.

Several people who run state unemployment agencies have complained to you as to why this decision burdens them. We think the focus should more appropriately be upon the burden faced by unemployed workers who have to endure waits of up to six months for unemployment benefits that they have earned but cannot access because the state prefers not to count the wages earned in the four to six month period immediately before the loss of their jobs.

The use of a base period which counts the wages in the four to six month period immediately preceding job loss is sometimes referred to as an "alternative base period" or "ABP". Those who would be benefited by the use of an ABP eventually become eligible without it if they wait long enough. The ABP does not create any new eligibility criteria. These people have already earned enough to meet the state's eligibility standards, and they have lost their jobs through no fault of their own. Their wage profile will look exactly the same when they qualify for benefits as it did when they applied. The four to six month wait for benefits, however, can have drastic effects upon the worker and his or her family.

The stories of M.B. and R.P. are typical. M.B. worked in an ambulance garage in Philadelphia. M.B. had been on welfare, and had gone to school to become an Emergency Medical Technician. It was the kind of job she had always wanted. Unfortunately, she was subjected to overt sexual harassment on the job. Nevertheless, she stayed until she was fired with a flimsy explanation and was replaced by a man. M.B. had worked long enough to have sufficient earnings under Pennsylvania's financial eligibility criteria. However, she needed to count her most recent wages before she could have access to her benefits. Like many people terminated under false pretenses, M.B. could not find other work, despite her efforts to do so. She had no choice but to return to welfare. She eventually lost her apartment, since even with welfare, she could not pay her rent. The last time M.B. was heard from, she was living in a city shelter.

R.P. is a young mother with two toddlers. She needed to stop working to care for them while they were small. She re-entered the workforce in December of 1995, working as a cashier at a check-cashing agency in Philadelphia. She worked hard, but was fired by an unscrupulous employer with little regard for the wage payment laws. This occurred in July of 1996. During her employment R.P. earned enough to be eligible for benefits under the unemployment compensation program. However, despite the fact that she is currently unemployed and in need

of that money to support herself and her three and four year old children, she has been told that she cannot gain access to it until October. She does not know how she is going to make ends meet until then, if she is unable to secure another job. Since she cannot expect a decent reference from her employer (who is also refusing to pay her some of the wages he owes her), her job prospects are not good.

The goals of the unemployment compensation system can never be met if people like M.B. and R.P., who have met the states' eligibility criteria and who become unemployed through no fault of their own, are denied timely access to the benefits which were intended to help them get back on their feet. Unemployment compensation was intended to assist the unemployed worker to meet his financial obligations while he was unemployed so that he could spend his energies looking for new employment. In designing the program Congress also recognized that the impact of unemployment extends beyond the unemployed individual into the local economy. The lesson painfully brought to public consciousness during the depression was that people out of work have no money to spend, depleting the market for goods and services being produced in other sections of the economy, and risking further unemployment as businesses downsize to reflect the decreased demand. Congress intended both to insure unemployed workers and to minimize the ripple effect that unemployment has upon the entire community.

Neither the goal of helping the unemployed person to remain self-sufficient nor the goal of stabilizing the economy during periods of unemployment can be accomplished unless unemployment compensation finds its way into the unemployed workers' pocket as soon as possible after unemployment occurs. The timing of the payments is as important as the money itself.

The base period like the one attacked in Pennington has draconian consequences for low wage workers and other workers, such as those in the building trades, who are genuinely attached to the work force, but because of their pattern of wage collection are unable to have access to unemployment benefits when they most need them. Low wage workers must work longer than others in order to acquire enough base wages to be eligible for the unemployment compensation program. They are the least likely to have savings or other private resources to tide them over while they wait for their benefits to become available. They typically work in jobs which provide little or nothing in the way of benefits or severance allowances, or any protection at all from arbitrary dismissal. For many, the acquisition of a low wage job was their ticket away from welfare dependency. Sudden unemployment with no access to the unemployment compensation benefits they have earned often leaves them with no recourse other than to go back on welfare, a step which has dramatic psychological as well as economic consequences for themselves and their families.

The base period considered by the Court in Pennington is used in many states across the country. This is a historical legacy which emanated from administrative need during the 1930's. Clearly at that point in time, long before computers and other technology, states in fact needed a fair amount of time to secure wage records from employers and record them into the system (most likely by hand). The definition of the base year as the first four of the last five completed calendar quarters was adopted not because of its usefulness in paying benefits as soon as possible, and not because it somehow measured a person's attachment to the work force, but because it was unrealistic to acquire and input the necessary information any faster.

"Administrative feasibility" is a flexible concept. A bureaucratic desire to do things the way they have always been done should not be permitted to undermine the economic security of the unemployed. It is clearly administratively feasible to access recent wage information with far greater speed today than it was in 1935. That being the case, there is no justification for making people who need to rely upon their more recent wages in order to access the system, to wait for up to six months in some cases before benefits can be paid. By requiring them to wait, the unemployment program is actually working against itself. It magnifies, rather than reduces, the impact of unemployment upon the workers, their families, and their communities. It frequently pressures people onto public assistance to meet

their basic needs. This is directly contrary to the public's interest in minimizing utilization of our country's welfare programs, and attenuates, rather than strengthens, the person's attachment to the workforce.

Both M.B. and R.P. have been unnecessarily victimized by the system which should have been there to help them overcome the obstacles which almost always accompany unemployment, particularly for low wage workers. They are not alone. Thousands of similar stories are being written every day as the American workforce replaces many of its high paying manufacturing jobs with low-wage, no benefit service jobs. Job security for a major segment of our population is a thing of the past, even in industries which were once thought to provide lifetime employment opportunities. It is ironic that at a time when industries nationwide are adopting newer technologies in order to enhance profits and in many cases, reduce the need for employees, the unemployment compensation system is tied to a pre-technology mode of operation which prevents workers from accessing benefits they have earned. Congress should not condone such a mindset on the part of state unemployment compensation authorities.

STATEMENT ON BEHALF OF MRS. LUELLA PENNINGTON AND THE PENNINGTON CLASS OPPOSING LEGISLATION TO REVERSE PENNINGTON V. DIDRICKSON

Introduction

On behalf of Mrs. Luella Pennington and the plaintiff class in Pennington v. Didrickson, 22 F.3d 1376 (1994), we are responding to the June 28, 1996 advisory issued by the Ways and Means Committee's Subcommittee on Human Resources (the "Subcommittee") concerning the proposed legislation to overturn the Pennington decision.

Since 1938, section 303(a)(1) of the Social Security Act has required that states' unemployment insurance laws provide for "methods of administration ... reasonably calculated to insure full payment of unemployment compensation when due." 42 U.S.C. § 503(a)(1) (the "when due clause"). At least since the Supreme Court's 1971 decision in California Department of Human Resources Development v. Java, 402 U.S. 121, the when due clause has been interpreted to "require that a State [unemployment insurance] law include provision for such methods of administration as will reasonabl[y] insure the full payment of unemployment benefits to eligible claimants with the greatest promptness that is administratively feasible." 20 C.F.R. § 640.3(a); Java, 402 U.S. at 130-33.

The "base period" in any state's unemployment insurance program is the time period within which claimants must have earned sufficient wages to qualify for benefits. As defined in section 237 of the Illinois Unemployment Insurance Act, 820 ILCS 405/237, Illinois's base period is comprised of the "the first four of the last five completed calendar quarters immediately preceding the benefit year" ("Illinois' base period"). Accordingly, Illinois' base period skips any wages earned by a claimant in both the calendar quarter in which he files his claim (the "filing quarter"), because that is not a "completed" quarter, and the preceding calendar quarter (the "lag quarter"), because that is the fifth of the five completed calendar quarters prior to the benefit year. Consequently, when Illinois determines whether a claimant has sufficient qualifying wages, it disregards any wages earned in both the filing and the lag quarters (the "lag period").

In Pennington, the Court of Appeals for the Seventh Circuit held "that section 237 is an administrative provision and, as such, is subject to the timeliness requirements of the 'when due' clause." 22 F.3d at 1387. The legislation's proponents, including Ms. Loleta Didrickson, who was the defendant in the litigation through much of its history, decry the Pennington decision. But they do so without ever discussing its reasoning. Indeed, Commissioner Richardson concedes that the proponents have appealed to Congress in the hopes of being heard by a forum that will not be restrained by an "intellectual exercise." Statement by Andrew N. Richardson ("Richardson Stmt.") at 3. In contrast, we urge Congress to read not only the Pennington decision, but also Java and its other progeny, and to consider the courts' reasoning and the legislative history underlying the when due clause. We believe that after intellectually honest reflection, Congress will agree that the Pennington decision assures prompt payment of unemployment insurance benefits in furtherance of a public policy that was embodied in the nation's unemployment insurance program at its inception because it is central to its purpose.

I. Illinois' Base Period Definition Is An Administrative Method, Not An Eligibility Criterion

A. Because the when due clause governs only the states' "methods of administration" of unemployment insurance programs, "applicable Federal laws provide no authority for the Secretary of Labor to determine the eligibility of individuals under a State law." 20 C.F.R. § 640.1(a)(2); see Ohio Bureau of Employment Services v. Hodory, 431 U.S. 471, 482-87 (1977). The proponents rely heavily on this principle. See e.g., Didrickson Stmt. at 2. As the court of appeals noted, however, the "truism [that the when

due clause governs administrative methods but not eligibility criteria] simply begs the question and, consequently contributes nothing to the inquiry before us." 22 F.3d at 1382.

What is required, of course, is to determine whether Illinois' base period is an administrative method or an eligibility criteria. An eligibility provision "define[s] the class of persons eligible for benefits." Hodory, 431 U.S. at 486-87. In an effort to suggest that a lag period is necessary to determine eligibility, the proponents characterize the Pennington claimants as those who "[a]re not monetarily eligible for unemployment benefits." Richardson Stmt. at 1. But that is not so. In fact, the Pennington claimants are, by definition, only claimants who have earned sufficient wages to qualify for benefits. 22 F.3d at 1385.

Moreover, the lag period does not exclude claimants from eligibility; it just delays the time at which the state will consider a claimant's most recent wages in determining his or her eligibility. To argue the contrary, the proponents ignore the single most important fact about the operation of the Illinois base period: that the Pennington claimants become eligible for benefits by doing nothing more than waiting until sufficient time has passed to file a second claim, since wages that are initially disregarded because they fall in a claimant's lag period, become qualifying wages by the passage of enough time so that they fall within the first four of the last five completed calendar quarters prior to the filing of the later-filed claim. Pennington, 22 F.3d at 1385.

Thus, although Illinois' base period delays the time at which the state will count a claimant's most recent wages toward eligibility, it does not prevent a claimant from using those same wages so long as he waits a sufficiently long time before filing a claim. Causing a claimant to wait to receive benefits, however, is just what the when due clause was designed to prevent. Java, 402 U.S. at 131-33.

B. The legislation's proponents also urge that Illinois' base period "ensures that unemployment insurance will be available for workers with a genuine attachment to the labor force, but not necessarily for those with only a marginal connection." Testimony of Loleta A. Didrickson ("Didrickson Stmt.") at 1; see id ("Employers ... should not bear the burden for individuals with little or no attachment to the world of work"). In fact, however, exactly the opposite is true: the lag period "causes ... [claimants] with relatively strong attachment to the work force to wait until that attachment has weakened before they can receive benefits." 22 F.3d at 1385. Thus, the contention that Illinois' base period restricts payment of benefits to claimants with stronger workforce attachment is not just wrong; it is perverse.

C. Furthermore, the proponents have repeatedly conceded that the purpose of Illinois' base period is solely administrative, not substantive. For instance, in the Pennington litigation itself, Illinois repeatedly admitted that the lag period "is necessary because some time is required for employers to report wages and for the [state agency] to make that information available in the local [unemployment insurance] offices where claims are first taken and adjudicated." 22 F.3d at 1387. And in his submission to the Subcommittee, Mr. Richardson concedes that whether states can shorten their lag periods is dependent solely on whether "technology permits states to collect and process wage information more quickly." Richardson Stmt. at 3. These concessions confirm what the court of appeals found: that Illinois' base period is "an administrative method employed to accommodate the time needs of a wage record [data collection] system. In a world of high-speed information exchange, the lag quarter would not exist; yet an eligibility requirement like the 'voluntary leaving' provision [which disqualifies claimants who leave work without good cause attributable to the employer] would." 22 F.3d at 1387.

II. The Pennington Decision Is Not Only Consistent With, But Required By The Historic Interpretation Of The When Due Clause

A. The legislation's proponents argue that Pennington "represents a 180-degree departure from the manner in which both the federal government and states have construed the Social Security Act, since the statute's enactment more than 60 years ago." Didrickson Stmt. at 1. They contend that this deviation from the historical interpretation of the when due clause was wrought by activist federal judges intent on usurping the legislature's "policy making authority", Didrickson Stmt. at 1, through "judicial fiat." Statement of Hon. Philip M. Crane, 142 Cong.Rec. ___ (July 11, 1996). In fact, however, like the district judge who decided the case, the three court of appeals' judges were all appointed by President Reagan. Moreover, the Pennington decision itself confirms that they are judicial conservatives.

For example, the proponents argue that "[t]he United States Supreme Court has held that the Social Security Act was intended to recognize the importance of each state establishing its own eligibility criteria for unemployment insurance." Didrickson Stmt. at 2. But that, too, just begs the question of whether Illinois' base period is an eligibility criteria or an administrative method. Moreover, the Pennington court's conclusion that Illinois' base period is an administrative provision, not an eligibility criteria, is not only consistent with Supreme Court precedent, it is required by two unanimous Supreme Court cases: California Department of Human Resources Development v. Java, 402 U.S. 121 (1971) and Fusari v. Steinberg, 419 U.S. 379 (1975). See 22 F.3d at 1386.

In Java, the Court considered the legality of a provision that suspended payment of benefits to any claimant who had won an initial determination, during the pendency of any appeal by the claimant's former employer. 402 U.S. at 122. Though the case concerned California's unemployment insurance code, the statutory provision at issue was used in 48 states. See Appendix to Appellants' Brief in Java, No. 507 (U.S. Sup. Ct. 1970) at 69-70. Nonetheless, in a unanimous opinion, the Court held that the provision violated the when due clause because "'when due' was intended to mean at the earliest stage of unemployment that payments were administratively feasible." Id. at 131.

After a thorough review of the Congressional history that led to enactment of the when due clause, Chief Justice Burger concluded that the when due clause was designed to provide prompt wage replacement to displaced workers both "to tide them[] over, until they get back to their old work or find other employment, without having to resort to relief", 402 U.S. at 131 (quoting HR Rep No. 615, 74th Cong, 1st Sess, 7 (1935)), and to "exert[] an influence upon the stabilization of industry." Id. at 132.

This history of when due jurisprudence belies the proponents' argument that Pennington represents judicial encroachment on legislative prerogatives. After all, the when due clause is itself a legislative enactment. And one with the backing of the Constitution's Supremacy Clause. U.S. Const., art. VI, cl. 2. It is, therefore, entirely appropriate for the federal courts to enforce the when due clause. Indeed, one cannot help but feel that the proponents disparage the federal courts so vigorously because they resent the fact that unemployed Americans went to the federal courts to enforce their rights against state policy that violates federal law. But just as the Java Court struck down a state's administrative provision because it delayed payment of unemployment insurance in violation of the timeliness demanded by the when due clause, the Pennington court concluded that Illinois' base period is an administrative provision that delays payment to eligible claimants.

B. The proponents contend, however, that "since the establishment of the unemployment insurance system, the Labor Department ... has considered a base period of the first four of the last five quarters to be consistent with the clause and, in fact, has suggested that the states use such a base period." Didrickson Stmt. at 2. That, too, is simply wrong. To the contrary, in 1962, the Secretary of Labor issued a policy statement urging states to keep their lag periods "as short as possible", Unemployment Insurance Legislative Policy: Recommendations for State Legislation, 1962, thus confirming not only that lag periods should not unnecessarily delay payment of benefits, but also that the Secretary has historically treated base periods as administrative methods, which are subject to his regulatory authority, rather than eligibility criteria, as to which he has no such authority. See Pennington, 22 F.3d at 1384.

The legislation's proponents rely on draft bills issued by the Secretary of Labor in 1932 and 1950, one of which includes a base period definition like the one used in Illinois. From these draft bills, the proponents contend that "[t]hroughout the history of the unemployment insurance program, determining the period that constitutes the base period for unemployment insurance claims purposes has been one of many eligibility criteria that federal law left to the states." Richardson Stmt. at 2; see also Crane Stmt. (Pennington is "diametrically opposed to the common practice recognized as lawful and legitimate for decades").

As the court of appeals noted, however, the "draft bills do not ... directly address the issue here: whether the lag period arrangement can be termed a matter of eligibility as opposed to a matter of administration." 22 F.3d at 1384. The court therefore concluded that:

> the mere fact that the draft bills take notice of a lag period similar to the ... [Illinois base period] does not indicate that the lag period is in compliance with the 'when due' clause or the corresponding regulations. A state must pay unemployment benefits 'with the greatest promptness that is administratively feasible.' 29 C.F.R. §640.3(a). Needless to say, what was 'administratively feasible' when the draft bills were written - 1937, 1950, and 1962 - is much different from what is administratively feasible in today's technologically advanced world. Id. at n. 6.

C. Recent history also belies the proponents' contention that long lag periods are acceptable. Congress recently empaneled the Advisory Council on Unemployment Compensation ("Advisory Council") to study the nation's unemployment insurance program. See P.L. 102-164. The Council was chaired by Dr. Janet L. Norwood, who was Commissioner of the Bureau of Labor Statistics and is a senior fellow at The Urban Institute. In its February 1995 report to the President and Congress, the Advisory Council recommended that "[a]ll states should use a movable base period in cases in which its use would qualify an Unemployment Insurance claimant to meet the state's monetary eligibility requirements." Unemployment Insurance in the United States: Benefits, Financing, Coverage, Advisory Council on Unemployment Compensation, Feb. 1995 at 17. The proponents thus ask Congress to reject a policy suggested to it by the very body Congress empaneled to provide precisely such advice.

D. Ms. Didrickson also argues that "[i]n the 1970's Congress itself expressly recognized and took no issue with the states' widespread use of base periods consisting of the first four of the last five quarters." Didrickson Stmt. at 2. But Congress dealt with base periods only in its enactment of 26 U.S.C. § 3304(a)(7), which was designed to control for a wholly separate problem of "double dipping" by those claimants who try to reuse wages for second claims. Accordingly, the court of appeals determined that § 3304(a)(7) "had nothing to do with the operation of the 'when due' clause and certainly did not address the issue of whether the type of base periods used in the Illinois statute violated that clause." 22 F.3d at 1383.

III. The Use Of An Alternative Movable Base Period Will Neither Increase The Risk Of Fraud Nor Substantially Increase The Costs Of Operating The Unemployment Insurance Program

A. The proponents also argue that Illinois' base period "streamlines administration and minimizes the risk of fraud" because it allows for verification of a claimant's wages, Didrickson Stmt. at 1, whereas use of an alternative movable base period "would entail either essentially taking a claimant's word for it as to the amount of [his most recent] earnings, thereby increasing the risk of fraud, or requiring additional reporting from employers to verify the earnings, thereby imposing new 'paperwork burdens.'" Id. at 3.

In fact, however, the testimony in Pennington confirms that a movable base period can be most easily designed by using the very same wage data - collected and processed in precisely the same way - that Illinois does now. The only difference would be that, instead of enforcing a mandatory delay on using a claimant's recent wage data, the state would assess eligibility based on those wages as soon as they were reported by the former employer and processed onto the state's data base, for any claimant who needed his more recent wages to qualify for benefits. But since exactly the same wage data would be collected in exactly the same way, a movable base period would neither require reliance on claimants' statements as to what their wages had been, nor impose new paperwork burdens on employers or the state.

B. The proponents also argue, however, that the Pennington decision "could have a costly impact upon employers and state government[s] ... and aggravate the federal deficit by hundred's of million's of dollars." Didrickson Stmt. at 1. She estimates administrative costs in Illinois at $ 12 - $ 15 million in one-time costs and $ 2.5 million in yearly operating expenses. Id. at 2-3. She estimates trust fund outlays of 1.5%, but also notes one study that, she claims, indicates that alternate base periods could raise state trust fund outlays by 4 to 6%. Id. at 2-3. From these estimates, she contends that trust fund outlays for a movable base period would be between $ 180 million to 750 million over 8 years, or $ 22.5 million to $ 93.75 million per year which, she claims, would trigger automatic tax increases. Id. She concludes from all these figures that the Pennington decision will "cause nationwide disruption in the various states' unemployment compensation system." Id.

None of this is realistic. First, as accurately described by the court of appeals, the claimants' evidence supports a narrowly-based challenge to the section 237-type base period; not a challenge based on any alternative base period that any litigant might conceive. 22 F.3d at 1380 n. 3. Furthermore, seven states (Maine, Massachusetts, New Jersey, Ohio, Rhode Island, Vermont and Washington state) already use movable base periods and Michigan and New York will begin doing so soon. Yet the sky has not fallen in any of those states. Indeed, the Advisory Council concluded "that advances in technology have made it feasible for all states to use the most recently completed quarter when determining benefit eligibility." Unemployment Insurance in the United States:

Benefits, Financing, Coverage, Advisory Council on Unemployment Compensation, Feb. 1995 at 16.

Moreover, the provision that the Supreme Court struck down in Java was used in 48 states. See Appendix to Appellants' Brief in Java, No. 507 (U.S. Sup. Ct. 1970) at 69-70. Yet the proponents offer no evidence that compliance with Java disrupted the nation's unemployment insurance program at all.

C. Ms. Didrickson's cost figures are enormously inflated. For example, her estimates of administrative costs include unnecessary additional costs for a wage request system to obtain wage data before it is reported in the normal manner. The evidence at trial confirmed that if Illinois did pay to add a wage request component to a movable base period, that alternative would be "administratively feasible" in the sense that, if there was no cheaper alternative, the costs of those systems would be worth the benefits they would generate to the claimants. But, in Illinois, the marginal benefits of adding a wage request component is too small to justify its greater expense over the alternative of simply using the most recent wage data when it is reported in the usual course. Thus, while IDES could enhance a movable base period system marginally by incorporating a wage request component, the when due clause does not require that it do so.

Ms. Didrickson estimates also include costs for a "reachback" component to find claimants who were previously denied benefits. But the Eleventh Amendment to the U.S. Constitution, U.S. Const., amend. XI, prohibits the courts from ordering any such relief. See Paschal v. Jackson, 936 F.2d 940 (7th Cir. 1991).

Illinois' insistence on calculating the costs of a movable base period by including a wage request and a "reachback" component is designed merely to inflate the "costs" of a movable base period. The following table compares Illinois' cost estimates with those components included and the same estimates with those components eliminated:

	Estimate With Wage Request and "Reachback"	Estimate Without Wage Request and "Reachback"
Conversion Costs		
Non-computer	$ 4.1 million	$ 411,260
Computer	$ 9.3 million	$ 5.8 million
TOTAL	$ 13.3 million	$ 6.2 million
Operating costs	$ 2.8 million	$ 400,000

The table confirms that, if the costs of a wage request and a "reachback" component are eliminated, Illinois' estimates of the conversion costs would drop $ 7.1 million, from $ 13.3 million to $ 6.2 million, and its estimate of the yearly operating costs would drop $ 2.4 million, from $ 2.8 to $ 400,000.

D. As for trust fund outlays, the evidence at trial confirmed that a movable base period in effect in Illinois during 1986 would have paid a substantial proportion of about 23,000 additional claimants approximately 13.6 million additional dollars, and approximately 13,000 claimants would have been paid benefits sooner. In 1994, the Director of the Illinois Department of Employment Security estimated that the additional benefits paid to claimants would be about $ 30 - $ 40 million a year. See Director Doherty's letter of July 7, 1994.

Ms. Didrickson's newest "high side" estimate is $ 93.75 million per year. But that assumes that, because the percentage of claimants who receive benefits would increase by 6 - 8% if the state used a movable base period, the trust fund outlays would also increase that much. That assumption is unquestionably wrong since the vast majority of claimants who would be benefitted by a movable base period are those who would receive at or near the minimum benefit amount.

Moreover, while the applicable federal statutes give the states wide latitude to assure the solvency of the trust fund by setting their own benefit amounts, tax rates and eligibility requirements, the when due clause is one of the few federal limits on the states' discretion. By assuring that states do not adopt methods of administration that unreasonably delay the payment of benefits, the when due clause enforces the congressional purpose of prompt payment to tide workers over during periods of unemployment and to prevent the deepening of recessions. Java, 402 U.S. at 130-33. Accordingly, a state may not justify a violation of the when due clause by claiming that it had to delay payment of benefits to maintain its trust fund balance. See id., 402 U.S. at 129-33.

The when due clause's assurance that states will honor the claimants' interest in prompt payment of benefits necessarily means greater outlays from the trust fund. But the nation's unemployment insurance program exists solely to provide prompt assistance to eligible claimants during periods of unemployment. Thus, to complain that the states are obligated to pay benefits promptly from the trust fund is to complain of the very purpose of the unemployment insurance system itself.

E. For the same reason, the tax consequences for employers is not a cogent reason for abandoning the when due policy. For many years, employers have not had to finance unemployment insurance to pay benefits to the Pennington claimants. Employers have therefore been permitted to escape that part of the excise tax they were supposed to pay for use of the nation's labor supply.

Indeed, a study by the U.S. Department of Labor, using data from Illinois, concludes that some employers obtain a form of subsidy by laying off workers while their wages are still within the lag period, thereby avoiding the charge associated with those workers' unemployment insurance claims. Unemployment Insurance and Employer Layoffs, Occasional Paper 93-1, U.S. Dept. of Labor (1993). The researchers estimated that "27 percent of all (UI chargeable) layoffs for a 4-5 quarter period were free layoffs to the firms initiating the layoffs ... [and that] the percentage of layoffs that are free varies from only 13 percent for the largest firms to 39 percent for construction firms." Id. at xiv. Moreover, they concluded that "this.UI subsidy actually tends to destabilize rather than stabilize employment." Id. at 3.

The General Accounting Office ("GAO") agrees. A 1993 GAO report to the Chairman of the Senate Committee on Finance concerned the reasons why the percentage of unemployed workers who receive unemployment insurance benefits has declined. Unemployment Insurance: Program's Ability to Meet Objectives Jeopardized, GAO/HRD-93-107 (Sept. 1993). In that report, which was based on data from Illinois, the GAO noted that "[s]tate officials ... said some employers control employee work schedules and earnings to ensure that they do not meet the qualifying requirements." GAO Report at 5.

The unemployment insurance tax is a fair excise on employers' use of the nation's labor supply. We ought not undermine a 60-year old policy of paying prompt unemployment insurance benefits to eligible workers because some employers who hire the nation's most vulnerable workers prefer not to pay their fair part of the costs of unemployment when they lay those workers off.

IV. The Percentage Of Unemployed Americans Who Receive Unemployment Insurance Benefits Is At An Historic Low, Making This A Particularly Inappropriate Time To Undermine The Protection Of The When Due Clause

The 74th Congress enacted the when due clause to assure that unemployed Americans like Mrs. Pennington receive prompt replacement of lost wages during periods of unemployment. See Java, 402 U.S. at 130-33. The term of the 104th Congress is a particularly inauspicious time to undermine that policy. In its 1993 report to the Chairman of the Senate Committee on Finance, the GAO confirmed that the percentage of unemployed workers who receive unemployment insurance benefits has declined to historic lows of less than 40%. Unemployment Insurance: Program's Ability to Meet Objectives Jeopardized, GAO/HRD-93-107 (Sept. 1993).

Moreover, in its 1996 report to Congress, the Advisory Council confirmed the GAO's conclusion, finding that, in 1995, 14 states paid unemployment insurance to a quarter or fewer of their unemployed workers, and that Illinois paid only 37.2% of its unemployed. Defining Federal And State Roles in Unemployment Insurance, A Report to the President and Congress, Advisory Council on Unemployment Compensation, Jan. 1996; see Table 4-2 "Ratio Of Unemployment Insurance Claimants To Total Unemployment, By State, 1995."

A recent study concludes that "[t]he presence of an alternative [movable] base period raises the number of monetarily eligible claimants by 6 to 8 percent." Vroman, Wayne, The Alternative Base Period in Unemployment Insurance: Final Report, Jan. 31, 1995. Thus, the Pennington decision offers some reversal of the precipitous drop in the rate of unemployment insurance recipiency. And the GAO has confirmed that "[t]he receipt of [unemployment insurance] benefits [is] an important factor in keeping unemployed workers above the poverty level." GAO Report at 5.

Statement of the Hon. Bill Thomas
Subcommittee on Human Resources
Concerning Unemployment Benefits
July 19, 1996

Mr. Chairman, recent communications between the Department of Labor and California show we have another problem to correct in restoring power to the States. Bluntly, the Department is saying California has to pay unemployment benefits to certain criminals being released from prison. If we are to give states the flexibility they need to deal with criminal behavior and to return prisoners to society with skills they can use in honest employment, we need to correct this aggregious case of elevating form over substance.

As the Subcommittee is aware, current federal law requires employers to pay federal employment (FUTA) taxes on work performed by their employees. This includes prison inmates who work for private companies through innovative work programs established in several states, including California. Today, some 200 people in California prisons are employed in jobs provided under agreements between the state and private businesses. However, FUTA taxes do not have to be paid for work by prisoners employed in prison operations such as the laundry or cabinet shop.

Since FUTA taxes are paid on behalf of some prisoners, the U.S. Department of Labor has ruled that these prisoners must be paid unemployment benefits upon their release from their "job"--essentially, when they are released from prison. Failure to comply is serious: California employers, for example would lose tax credits worth $1.7 billion for FUTA taxes they pay on other workers if the California program is disqualified.

Why does Labor take this position? The federal unemployment insurance program only permits denial of employment benefits in three cases: if the worker's income exceeds certain limits; the claim is fraudulent; or the employee was fired for misconduct. Since prisoners lose their jobs when paroled or released from prison, they do not fit the exceptions.

California voters established the Joint Venture Program in 1990, creating a private work program for prison inmates. Criminals' wages are used to compensate victims, offset incarceration costs, and set aside funds (20%) for the inmate's support upon his or her release from prison. In 1996, California voters overwhelmingly passed an initiative (Proposition 194) that denies unemployment benefits to criminals participating in the Joint Venture Program.

The Department of Labor decision would force Californians either to pay out unemployment benefits to released prisoners or to eliminate a program that has been successful in helping criminals transition back into the workforce. Allowing employees to lose $1.7 billion in credits for taxes they pay on the services of ordinary working people is not an option, needless to say.

Legislation I have introduced, H.R. 3858, would change the law to treat all prison inmates who participate in work programs the same: their services would be exempt from the FUTA tax. This would effectively deny unemployment benefits to released prisoners and prohibit the Department of Labor from placing such a ridiculous requirement on the states. The bill's enactment would give states an additional tool to use in trying to reform criminal behavior and I hope my colleagues will agree to its adoption in the near future.

COMMONWEALTH of VIRGINIA
Office of the Governor

George Allen
Governor

FOR THE RECORD

STATEMENT OF GOVERNOR GEORGE ALLEN
TO THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON HUMAN RESOURCES
JULY 11, 1996

DEVOLUTION OF THE EMPLOYMENT SECURITY SYSTEM

Mr. Chairman and Members of the Subcommittee:

Since my election as Governor of the Commonwealth of Virginia in 1993, I have sought not only to preserve but to enhance the prerogatives of states and the people within our federal system. I believe that transferring the administration and financing of the employment security system to the states would do just that.

OTHER GOVERNORS CONCUR

I am not the only governor to believe that the states should be empowered to finance and manage their own employment security systems. When I presented my proposal to devolve the employment security system to the National Governors' Association Economic Development and Commerce Committee in February, the governors voted unanimously to pursue this issue.

The reforms I proposed could cut payroll taxes in most states, reduce burdensome paperwork, and improve services for workers.

BACKGROUND

The nation's employment security system includes unemployment insurance, employment service, and labor market information programs.

Employers pay two taxes to support the current system. The Internal Revenue Service (IRS) collects a federal payroll tax under the Federal Unemployment Tax Act (FUTA) to finance program administration. State employment security agencies collect a state payroll tax to fund unemployment benefits.

The revenues from both federal and state taxes are deposited in various accounts in the Federal Unemployment Trust Fund (UTF) and can be used only for administering the employment security system and paying benefits.

PROPOSED REFORMS

The changing nature of employment and the workforce make the employment security system more important than ever to employers and jobseekers, yet there are inefficiencies which should be addressed.

- **America's businesses are burdened by having to file *two, separate* reports and pay *two, separate* taxes to *two* government entities.** The FUTA paperwork burden alone costs U.S. employers an estimated $291 million each year.

- **Many states' employers pay unnecessarily high federal unemployment taxes.** Of the 53 states and jurisdictions, employers in 47 paid more in federal unemployment taxes than their states received in 1994, the last year for which figures are available.

- **All available funds for states to run the employment security system are not appropriated by Congress and appropriations continue to decline.** According to U.S. Department of Labor projections, in Fiscal Year 1995 only 61 percent--or $3.47 billion of $5.7 billion in revenues--was appropriated for state administration of the employment security system. Yet, the House Appropriations Committee, in its FY 1997 Labor-Health and Human Services-Education funding bill cut $38 million from the FY 1996 level for state employment services and more than $200 million from the Administration's estimate of the funds needed to serve those entitled to unemployment benefits in FY 1997.

The following are the key elements of my devolution proposal:

- **Maintain a national employment security system but eliminate the burdensome federal mandates which cause inefficiencies and impose increased costs to the states.** Federal oversight should be limited to ensuring that state laws and policies conform to the basic requirements that would be retained in FUTA, to provide a public employment service and an unemployment insurance system.

- **Effectively eliminate the collection of the FUTA tax by increasing the offset credit for states from 90 percent to 100 percent as long as they conform to basic, national requirements. Taxing authority for administrative purposes would be transferred to the states.** Each state would determine and collect taxes to finance its employment security system. For employers, this positive reform would mean elimination of the current 0.2 percent surtax, a savings of $1.4 billion per year, and relief from the costly burden of filing two different sets of forms.

- **Hold harmless, at least for a transition period, those few states that now receive more in federal grants than their employers pay in taxes.** Funds from the current administrative account in the trust fund could be used to supplement the unemployment taxes paid in these states for at least five years.

- **Deposit state funds collected for benefits and administration in the UTF, which would remain in the federal budget.** Changes to the employment security system may affect the budget deficit and require offsets; however, this would minimize the impact.

CONCLUSION

Devolution of the employment security system is a good idea whose time has come. Funding for unemployment insurance, employment service, and labor market information programs comes from employer-paid taxes which can be used only to support these programs. States should be given the resources and the authority to develop systems responsive to the needs of their workforces and employers. The benefits can include payroll tax cuts in most states, reduced burdensome paperwork, and improved services for workers.

United States House of Representatives
Ways and Means Committee
Subcommittee on Human Resources

July 11, 1996

Testimony on the Transfer of the Administration and Financing of the Unemployment Compensation System to the States

By
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Mr. Chairman, Members of the Committee, thank you for inviting me to testify on the possible transfer of the administration and financing of the Unemployment Compensation System to the states. Unfortunately, prior commitments precluded me from appearing before the committee today. Please accept my written testimony and enter it into the record.

It should be noted that the following testimony is my own view and does not necessarily reflect that of The Heritage Foundation.

I. BRIEF OVERVIEW OF UNEMPLOYMENT COMPENSATION SYSTEM

The Unemployment Compensation (UC) system has two main objectives. It is to provide temporary and partial wage replacement to recently unemployed workers, and help stabilize the economy during recessions. To accomplish these two objectives the UC system consists of two programs; Unemployment Insurance and the Employment Service (UI/ES). The UC program currently is financed by two separate taxes, with two different tax forms, by two levels of government. A Federal Unemployment Tax (FUTA) of 0.8 percent[1] on the first $7,000 of each employees wages and state unemployment insurance taxes that average 0.9 percent of total

[1] The current 0.8 percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax of 0.2 percent. The surtax was first passed in 1976 to restore depleted state UI accounts and was suppose to expire in 1987. Since 1987, the surtax has been extended four times primarily to fund extended benefit programs and is now suppose to expire in 1998.

wages.[2] The revenue raised by FUTA is designated for Unemployment Insurance (UI) administration and maintaining a system of Employment Service (ES) offices. Portions of FUTA revenues also fund the federal half of the Extended Benefits Program and federal loans to depleted state accounts. State UI tax revenues fund their weekly UI benefit payments and the state half of the Extended Benefit Program. FUTA revenues are deposited in three federal accounts and state UI tax revenues are deposited in 53 state accounts maintained by the federal government (one for each state, D.C., Puerto Rico, and the Virgin Islands). At the end of fiscal year 1995, state accounts in the UI Trust Fund had balances totaling $35.9 billion and the three federal accounts had balances totaling $11.9 billion. Like the Social Security Trust Fund, any positive balance in the UI Trust Fund effectively is used to fund other federal programs for as long as there is the federal budget is running a deficit. General revenues are used to fund federal unemployment benefit programs and allowances such as Trade Adjustment Assistance and NAFTA Transitional Adjustment Assistance.

II. WHY THE UI/ES SHOULD BE TRANSFERRED TO THE STATES

When UC was enacted in 1935, Congress intended it to be a federal-state partnership. The federal government was to set broad parameters for the system, provide adequate and equitable funding for state administration, and oversee state law and operations to ensure compliance and conformity. The states were to be responsible for carrying out the program while complying with all federal laws and regulations, as well as their own state requirements. However, the federal government has used the state conformity process to frequently upset the balance of administrative funding and workloads by dictating that states absorb the costs of administering additional programs.[3] Moreover, the state conformity process has resulted in a "one-size fits all" approach that does not address the needs of individual states, nor provide states with the flexibility to address the needs of individual workers.

Over the past decade, federal budget constraints have had a detrimental effect on the services provided to unemployed workers by the state UI system and ES offices. Even though FUTA revenues collected for UI and ES administration have been more than sufficient, Congress continues to extend the 0.2 percent FUTA surtax on jobs and limit UI and ES administration appropriations.[4] This effectively masks the true size of the federal deficit. The federal government has come to use the UI system as a source of funds for programs that lead to longer

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[2] The state unemployment insurance tax varies from state to state, is paid by employers and is experience-rated (employers with few layoffs typically have the lowest tax rates). State legislatures determine the tax rate and the taxable wage base. Twelve states limit taxable wages to the federal minimum of $7,000, other states have ceilings raging from $8,000 in eight states, to $25,500 in Hawaii.

[3] Edwin M. Kehl, "Administrative Simplification of Unemployment Compensation Programs," in W. Lee Hansen and James F Byers eds., "Unemployment Insurance: The Second Half-Century,' The University of Wisconsin Press, 1990.

[4] The balance in the Employment Security Administration Account will be $2.4 billion in September 1995. This is $1.01 billion more than the statutory limit. There is also a $7.4 billion balance in the Federal Unemployment Account that has been built up using surplus FUTA payroll taxes. In fiscal year 1995, Congress withheld over $900 million in FUTA revenues.

periods of unemployment for workers[5] and unnecessarily high payroll taxes. This is contrary to the primary purpose of the UI system[6] and reduces real wages.[7]

In fiscal year 1994, employers in 25 states paid far more in FUTA taxes that their states got back (these states received less than 60 percent of their FUTA taxes). In all 46 states received less than their total FUTA taxes paid. As a result, many states' employers are paying unnecessarily high payroll taxes that limits job growth and reduces state services. For example, in FY 1994, employers in Tennessee paid $113.9 million in FUTA taxes but the state received only $43.8 million in FUTA grants to administer their UI/ES program, a loss of $70.1 million. Employers in Florida paid $290.7 million in FUTA taxes but the state received only $116.7 million back from the federal government, a loss of $174 million. All told the federal government collected $5.539 billion in FUTA taxes in FY 1994 and after skimming money off the top for bureaucracy, demonstration projects, it runs the remainder through a maze of formulas and equity adjustments and then returns on average about 60 percent back to the states.

Under the current UC system employers also are burdened by having to make reports and pay two separate taxes (federal and state) for what is essentially one system. It is estimated that the paperwork burden for filing the FUTA tax return costs the nation's employers almost $500 million annually. This burden directly reduces economic development and job growth and could easily be eliminated.

Studies show that states can effectively decrease the duration of unemployment and thereby reduce payroll taxes and increase jobs.[8] The UC program should be reformed to limit the federal role in the system, as Congress originally intended, and to restore responsibility and accountability for the program to the states.

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[5] Lawrence F. Katz and Bruce D. Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," National Bureau of Economic Research, Working Paper No. 2741, October 1988. This study concluded that extending the duration of UI benefits from 6 months to 1 year will increase the mean duration of unemployment by 4 to 5 weeks. Examples of federal programs that increase the duration of UI benefits are the extended benefit programs and trade adjustment assistance.

[6] In today's economy, the primary purpose of the UI/ES system is to move workers that have permanently lost their jobs into new ones as quickly as possible.

[7] Daniel S. Hamermesh, "New Estimates of the Incidence of Payroll Tax," Southern Economic Journal, Winter 1979. Research on the incidence of taxation has generally concluded that payroll taxes are predominantly, if not completely, borne by labor in the long-run through lower real wages.

[8] Bruce D. Meyer, " Policy Lessons from the U.S. Unemployment Insurance Experiments," National Bureau of Economic Research, Working Paper No. 4197. The willingness and ability of states to explore innovative ways to reduce UI duration is evident from the number of the state UI experiments have been wholly state funded.

III. RECOMMENDATIONS

- **Transfer the financing and funding for the UI system and Employment Service to the states.**

This should include a repeal of the temporary 0.2 percent FUTA surtax and increase the FUTA offset[9] from the current 90 percent to 100 percent if a state conforms with federal law. This will return $1.4 billion per year to employers and stimulate employment and wage growth. The federal Employment Security Administration Account (ESAA) should be phased out. Existing funds in the ESAA could be used for transition costs. Any funds remaining in the ESAA should be allocated to the states' accounts that remain at the federal level.

States should be allowed to collect one UI tax for administration and benefits. Each state would then be responsible, and accountable, to their employers for UI payroll tax dollars and for the administration and effectiveness of the UI/ES system. The combined state tax should remain dedicated to funding the UC system and the states should be prohibited from dipping into their accounts for anything.

- **Repeal the Wagner-Peyser Act and amend FUTA to require states to establish public employment offices in labor market offices designated by state legislatures.**

Each state should have the flexibility to deliver job placement assistance in ways that meet the needs of its employers and job seekers. However, states should ensure reasonable access to services for workers and to register for work all eligible claimants who are not temporarily laid-off. Reform must enable states to explore ways to integrate employment services and reduce the duration of unemployment payments by moving the unemployed into new jobs more quickly. This could include opening up the job placement assistance offered through state ES offices to private competition and other UI innovations.

- **Eliminate the federal extended benefit program and the federal extended unemployment compensation account (EUCA).**

Funds in the EUCA should be transferred to the state UI accounts based upon a state's relative share of covered employment. The 1992 federal amendments that made it easier for states to trigger extended benefits (EB)[10] should be repealed. States should have the responsibility to determine the number of weeks UI benefits are paid. The 1992 change made it easier for states to qualify for extended benefits and gave an incentive for individuals stay on unemployment

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[9] The actual gross FUTA tax rate is 6.2 percent. However, employers in states with federally approved UI programs (all 50 states) may credit 5.4 percent (90 percent FUTA offset) against the 6.2 percent tax rate, making the net FUTA tax rate 0.8 percent.

[10] The 1992 amendment allowed states to trigger EB based on a certain percentage of its total unemployment rate (TUR) instead of its adjusted insured unemployment rate (IUR). The IUR is computed by dividing the number of people claiming UC benefits by the number of people in jobs covered by UC. The TUR is the ratio of all unemployed workers to all workers in the labor force in that State. Eight states (Alaska, Connecticut, Kansas, Maine, Oregon, Rhode Island, Vermont, and Washington) have approved the use of the TUR triggers.

benefits longer even when jobs were available. By basing the trigger for extended benefits on a states' total unemployment rate versus a state's insured unemployment rate, Congress also broadened considerably who can qualify for extended benefits. Those who argued for this change claimed that basing benefits on the insured rate meant that many of the unemployed were not receiving benefits and therefore the program was not working as intended. But, as pointed out at that time by Labor Department officials, this gap between the number of people who were unemployed and those collecting benefits is normal and an intended purpose of the program.[11]

- **Fund the Federal Unemployment Account (FUA) that is used to loan money to insolvent state UI accounts with either general revenues or a state fee.**

Funds in the FUA come from a portion of the FUTA payroll tax on jobs.[12] The federal government uses the FUA to provide loans to states that have depleted their UI accounts during severe recessions. When the FUA is not being used for state loans, the surplus that builds up in the account is essentially used to fund other government programs and amounts to a tax on jobs to reduce the deficit. At the end of September 1995 there was a $5.9 billion surplus in the FUA.

- **Repeal the Disabled Veterans Outreach Program and the Local Veteran Employment Representative Program and amend FUTA to incorporate the veteran preferences already in Title 38 of the US code (Veterans Benefits).**

The administrative efficiency of the ES offices could be significantly improved by repealing barriers to the integration of veterans' services with other employment services. As the Vice President's National Performance Review noted in calling for the removal of barriers,[13] DoL's Veterans' Employment and Training Service provides for state-employed, federally funded, employment specialists to serve veterans in local state employment service offices. However, these staff are legally prohibited from helping non-veterans." So, if a local office is crowded with non-veterans," points out the NPR, "these specialists cannot help out--even if they have no veterans to serve." Employment Service staff would be used more efficiently and the public better served by eliminating this requirement.

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[11] Benefits are generally paid to workers with substantial labor force attachment who have lost their jobs through no fault of their own -- not to workers who quit their jobs voluntarily, who were fired for cause, or who have had no recent employment, such as those who are entering or reentering the labor force. The some of the difference between the insured unemployment rate and the total employment rate is also due to the exclusion of self-employed, certain agricultural labor and domestic service workers, railroad workers, and certain seasonal camp workers from collecting UI benefits.

[12] FUTA funds are indirectly deposited the FUA when the EUCA and Employment Security Administration Account (ESAA) have reached their statutory limits. The ESAA is used for financing the administrative costs of the employment security program and should be phased out. Funds in the ESAA should be allocated to the state UI accounts for the administration of their UI programs.

[13] *From Red Tape to Results*, p. 80.

- **Enable state legislators to determine the ES administrative budgets, payroll taxes, and UI benefits under limited federal guidelines.**

The UI system is an experience-rated and employer-paid payroll tax. The system was set up with specific objectives and a designated tax as its funding source. Federal or state proposals that would combine the funding sources for the ES program and job training programs are unwise. Job placement services have different goals, populations, and outcomes, from those of training programs. ES offices are suppose to get unemployment claimants get back to work quickly, thereby ensuring employer taxes are as low as possible. But job training programs often do not share that objective. Suggesting that FUTA payroll tax funds be utilized for anything else but paying unemployment benefits and funding state job placement assistance is merely a backdoor way of introducing a payroll tax for training. Transferring ES funding to the states removes the potential for Congress to dilute the mission of the ES system and divert funding for other purposes.

The limited federal guidelines should include the following:

- The single state UI tax for both administration and benefits should be experience rated.
- Funds should be used only for program administration and paying weekly benefits, and capped at levels necessary for proper and efficient administration during periods of high unemployment.
- States should be required to continue cooperative and financial contracts to administer the interstate benefit program.
- Federal funding for the administration and payment federal employee UI benefits, military separations, and disaster unemployment programs should be deposited in state UI accounts as needed.
- Federal oversight should be limited to determining if state laws conform with federal requirements.

IV. CONCLUSION

The recommendations presented here for the transfer of the UC system to the states constitutes a modest, achievable proposal that will not unduly affect the federal budget. If enacted such a transfer will enable states to reduce payroll taxes, increase jobs and take-home pay, reduce paperwork burdens, and improve services for unemployed workers.